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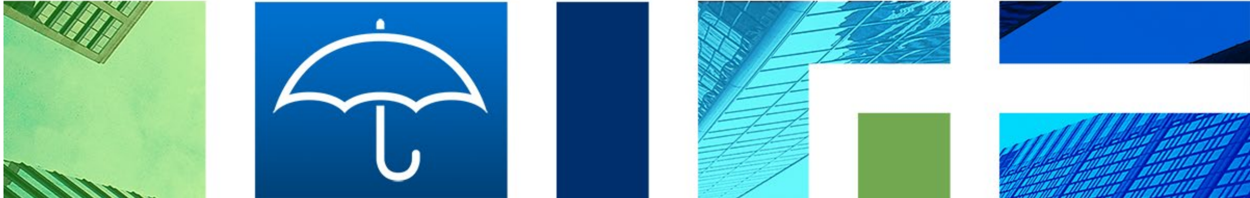

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Splitting the Difference: Why Careful Structuring and Regular Monitoring of a Split-Dollar Life Insurance Plan Might Benefit Employers and Employees

Bryan Bloom and Brian M. Balduzzi

Split-dollar life insurance can serve a multitude of uses. In times of a tight and competitive hiring market, employers may consider split-dollar life insurance as one of many diverse strategies to attract and retain desired employees. These plans are best established for key employees as a fringe benefit, but other uses include private split-dollar setup between individuals, an individual and a trust, or two trusts. This intergenerational split-dollar can supplement a well-designed estate plan.

This article will focus on split-dollar as an employment incentive–though the fundamental concepts apply across the board. In the compensation setting, a business may pay life insurance premiums for a policy on the employee's life. This split-dollar plan may not only accomplish an employee's wealth-transfer goals, but also may establish a business's replacement fund for a valuable employee. These split-dollar arrangements can vary depending on the interests of the employer and employee, and both employers and employees should consider educating themselves on the various structures, benefits, and considerations as part of their employment negotiations and wealth-transfer planning.

Types of Split-Dollar Plans

Split-dollar plans are typically structured as an economic benefit arrangement with an endorsement or as a loan arrangement with a collateral assignment. In some cases, a nonequity collateral assignment (NECA) or a switch-dollar strategy might be used.

Economic Benefit with an Endorsement: Under an economic benefit/endorsement split-dollar plan, the employer is the policyowner and the employer-owner shares the death benefit with the employee-participant. Under this plan, a business allows the employee-participant to name a beneficiary on all or a portion of the policy by filing a supplemental form (the "endorsement") with the life insurance carrier, naming their desired beneficiaries of the portion of the death benefit. The employer-owner pays the policy premium annually, and the employee-participant includes the "economic benefit" of the endorsed death benefit as taxable income. If the employee-participant dies while the endorsement split-dollar plan is still in effect, the designated beneficiaries receive the endorsed portion of the death benefits (most often the full amount) with the employer-owner receiving the remaining portion. If the

endorsement split-dollar plan is terminated, the employer-owner can keep the life insurance policy and remove the endorsement, or they can transfer the policy to the employee-participant. There is no cost to the employee-participant unless the policy is transferred to them. This endorsement split-dollar plan is most often used to provide a low-cost death benefit to the employee-participant as a fringe benefit or where the employer wishes to own the policy and/or obtain key person protection.

The economic benefit cost is calculated based upon the employee-participant's age, the death benefit, and the risk factor provided in the Table 2001 published by the Internal Revenue Service (IRS). This economic benefit increases each year as the employee-participant ages, so many employee-participants might benefit from reviewing these plans and their costs and then deciding whether to terminate the split-dollar plan or change to another type of arrangement. Some employee-participants may also try to lower the economic benefit rates by making the endorsement split-dollar plan with a survivorship policy.

Loan Regime with a Collateral Assignment: In a loan regime split-dollar plan, the employee-participant owns the policy, and the employer pays the premiums. Each premium payment is treated as a loan from the employer to the participant (or trust, as the case may be), and the employee-participant provides the employer with an interest in the policy through a collateral assignment. The employee-participant must pay interest on the loan each year, either out-of-pocket or as accrued or imputed income; if imputed income, the employee-participant may owe income tax on this interest. The collateral assignment is filed with the insurance carrier, protecting the employer's interest in the policy until the employer is repaid. Until the employer is repaid, the employee-participant can only access the cash value of the policy in excess of the loan balance (the "equity"), and, upon the employee-participant's death, the death benefits either repay the loan to the employer or the employer forgives all or a portion of the debt. Similarly, if the plan is terminated, the employee-participant must repay the loan using the policy's cash value or other funds, unless the employer forgives the loan. The loan regime plan allows the employee-participant to own the policy, but also to provide access to the policy's cash value.

The collateral assignment balances benefits to the employer with benefits to the employee. From the employer's perspective, in addition to providing a nice fringe benefit to attract and retain employees, the employer can selectively provide the benefit to employees and its premium costs can be recovered through the death benefit. From the employee's perspective, the employee owns the life insurance, receives a tax-exempt death benefit (when properly structured) and, depending upon the structure of the insurance, can access some of the cash build-up.

Nonequity Collateral Assignment: One "hybrid" structure is the nonequity collateral assignment split-dollar plan. In this structure, the life insurance policy is owned by the employee-participant, and the employer pays the premiums with expectations of repayment in the future. In this case, the employee-participant agrees to repay the employer the greater of the policy's cash value or cumulative premiums paid when the plan terminates. Like the endorsement split-dollar plan, the employee-participant pays income tax each year on the death benefit cost associated with the death benefit they are entitled to receive.

If the employee-participant dies while the plan is still intact, the employer will receive the greater of its premiums paid or the policy's cash value from the death benefit, and the employee-participant's designated beneficiaries will receive the remainder. If the plan terminates prior to the employee-participant's death, the employer is repaid the greater of the cash value or premiums paid, or the employer can forgive this debt in whole or in part; any forgiveness may be income taxable to the employee-participant. This NECA split-dollar plan may be beneficial where the employee-participant

wants to own the policy, the death benefits are important for the employee-participant's wealth transfer goals, and the employee-participant needs help paying the premiums. Employers and employees may consider reviewing these plans to determine if, and when, the policy cash value exceeds the total premiums paid. The parties may then determine if changes, such as switching to a loan regime plan, might be desirable.

Switch-Dollar Plan: A switch-dollar plan starts as an NECA split-dollar plan, and, at a future date, may switch to a loan regime split-dollar plan. Many survivorship policies switch at the death of the first of the insured to die whereas, for a single-life policy, the switch occurs just before the policy's cash value exceeds the premiums paid, or when the economic benefit cost exceeds the loan interest costs. At the time of the switch, the loan amount will equal the outstanding repayment obligation under the NECA split-dollar plan, which is the greater of the premiums paid by the employer or the cash value of the policy; the future premiums paid will be considered a loan by the employer. Upon the employee-participant's death, the split-dollar loan is repaid to the employer from the death benefits (with the remaining benefits paid to the designated beneficiaries), or, if the plan is terminated, the loan is paid from a combination of the policy cash value and the employee-participant's other assets. As with a loan regime split-dollar plan discussed above, the employer may also forgive all or a portion of the loan.

This switch split-dollar plan is often used for survivorship policies because of the increased costs at the death of the insured, or, for single-life policies, to decrease the income taxes owed. Reviewing when to affect this switch is an important part of monitoring these policies and may be a valuable consideration for the employer and employee.

Other Considerations

In addition to researching these split-dollar plan options, employers and employees should consider the income and estate tax implications of these plans. For example, if employers own the life insurance policies under the endorsement or NECA split-dollar plans, both parties should ensure that the certain requirements are met to keep the tax-exempt death benefit for the designated beneficiaries. The employee-participant may also consider discussing the proposed split-dollar plan with their estate planning attorney to determine if an irrevocable life insurance trust might purchase the policy, or if the split-dollar plan has other unintended gift and estate tax consequences or liquidity issues. Employers and employees might be limited from using the loan regime or switch split-dollar plans because of the Sarbanes-Oxley Act and its prohibition against personal loans to directors and executive officers of publicly traded companies. Other types of life insurance policies may also not be appropriate for loan split-dollar plans because of other federal laws.

Split-dollar plans can be a useful way to attract and retain executives or key persons for an employer, and they can be a valuable estate planning vehicle for employees wishing to negotiate additional fringe benefits from their employers. Understanding the various types of split-dollar plans, discussing the advantages and disadvantages and any restrictions with an attorney, and monitoring and reviewing the plan are important steps for both employers and employees.

Finally, while the focus of the above has been on the employer-employee use of split-dollar, the same concepts apply in a pure estate planning context. For example, for intergenerational split-dollar plans, a dynasty trust and a nondynasty trust might enter into a similar arrangement. The value and appropriate structure in those cases is very fact-specific, but the above concepts apply.

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https://www.faegredrinker.com/en/insights/publications/2023/8/careful-structuring-regular-monitoring-split-dollar-life-ins-plan-might-benefit-employers-employees

Clarity Is Needed to Help Clients Plan for the Benefits of Life Insurance and Long-Term Care

Holly Snyder

Like life insurance, long-term care (LTC) is a topic many people don't talk about. Some don't even want to think about it, preferring to avoid the uncomfortable feelings that long-term care elicits or making worst-case assumptions about what long-term care entails.

But neither inaction nor avoidance serves clients well. The time when many people finally come around to considering LTC is when they or their family members need it. At that point, it's too late for planning. It's all about managing the cost of care.

But the need for LTC planning is real. This past June, we collaborated with LIMRA and the U.S. National Council on Aging to poll Americans across different generations and demographic profiles to better understand their perspectives about LTC.

My first impression of the survey results is that people are by and large confused about LTC. Many consumers say they have a good understanding of long-term care and LTC insurance, but when pressed on the specifics, they really don't know what it is.

For you as financial professionals, there is an opportunity to address the knowledge gap between what clients think they know about LTC and what they actually need to understand to plan properly for future costs.

Defining long-term care

As part of the survey, we asked respondents to tell us how important it was to them to have LTC insurance. Over 70 percent said it was either very or somewhat important.

Then, we presented this definition of what LTC entails:

- *Long-term care (LTC) provides support and services to help people who cannot perform some or all aspects of daily living due to aging, chronic illness, and/or cognitive impairment.*
- *Long-term care can take place in a variety of settings including in-home health care, assisted living, adult day care, and nursing homes.*

More survey results revealed the lack of knowledge about LTC insurance.

Digging into this, we found that many people who thought they had LTC insurance were thinking of long-term disability insurance offered through their employers (51 percent in our survey). Another 30 percent were confusing LTC insurance with their current health insurance coverage. The reality is, neither type of insurance covers LTC costs.

From a financial professional perspective, there's an opportunity for you to help clear up this confusion and start clients on a path toward a plan for LTC and a more secure financial future.

Confusion about long-term care creates planning opportunities.

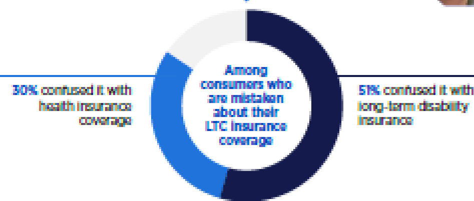
A new Nationwide Retirement Institute® survey, conducted in partnership with LIMRA, found significant misunderstanding among consumers about long-term care (LTC) and LTC insurance. Because of these mistaken beliefs, many people avoid talking about long-term care with anyone—spouses, other family members or financial professionals—and put off planning for future LTC costs.

Financial professionals can help clients feel more confident in their financial future by clearing up the misperceptions about LTC and addressing the potential costs for long-term care as part of their clients' financial plans.

Misperception of LTC coverage is common.

18% of consumers self-report that they currently own LTC insurance.

According to industry data, only around 3% have purchased LTC insurance.[1]



Neither long-term disability nor health insurance cover LTC costs.

It's a good time to stress the importance of LTC planning.

Around **1 in 4**

Only around **1 in 5**

62% of LTC-informed consumers say having long-term care insurance is either important or very important.

With so much confusion about long-term care, don't make assumptions about your clients' level of preparation. Some may say **"I'm covered"** when they really aren't.

Take the time to talk about long-term care planning with clients.

30% of survey respondents are open to discussing long-term care costs with a financial professional. This is an opportunity for you to connect with them about the importance of LTC planning and LTC insurance to their overall financial plans.

Resources from Nationwide help simply complex topics like long-term care so you can help your clients plan for a more secure financial future.

Visit https://nationwidefinancial.com/products/life/long-term-care

LTC confidence exceeds knowledge

First, clients must be ready and open to have this conversation. More often than not, these conversations are happening at home among family members. Half of all respondents in our survey said

they have discussed LTC costs with their spouses, 18 percent with their children, and 11 percent with their parents. Those numbers are encouraging, although only 18 percent of respondents have talked with a financial professional about LTC costs. In fact, 27 percent of people haven't talked to anyone about LTC.

Despite some confusion surrounding long-term care, consumers feel pretty confident about knowing how to cover LTC costs. In our survey, almost half of consumers (49 percent) feel somewhat or very knowledgeable about LTC insurance.

However, when a client says they're already covered for these potential costs, don't assume they're correct. Many won't be. A simple definition of what LTC is and what LTC insurance covers can be an easy and effective way to start the conversation.

The price of aging in place

When you start talking with clients about LTC, you may discover that some clients have new or surprising perspectives that may challenge the conventional wisdom about LTC. As one example, the growing interest in artificial intelligence (AI) is reaching the health care industry (as it is with nearly all industries these days). AI holds the promise of breakthroughs in medical research, which could result in more people living longer, healthier lives.

Consumers seem accepting of the role AI may play in providing care later in life. One-third of those polled in our survey think they'll receive home-based LTC from AI and robots—although the majority of people (65 percent in our survey) still prefer human touch when it comes to providing health care.

Understandably, most people want to receive LTC if needed in their homes. Our survey confirmed this consumer preference; 75 percent said they would prefer home-based care if they ever needed LTC. However, there are expenses for home-based LTC that clients should be aware of and plan for. In-home LTC may require additional costs for homeowners to modify their existing residences such as adding ramps, widening doorways, or updating bathrooms, for example.

When we asked survey respondents more about home-based care, 34 percent said their current residence is not set up or suitable for aging in place. In addition, 43 percent are concerned that the city or neighborhood where they currently live won't be suitable for aging in place. But many clients may not be aware that LTC can be used to help provide both formal and informal care in the home, which can prove valuable for helping people live in their homes or preferred area for longer.

Aging in place may not always be possible for surviving spouses or clients who are single. Home-based LTC will likely not be feasible for clients needing extensive or specialized care. While aging in place is still preferred, clients shouldn't count on it. That makes LTC insurance all the more important as part of a client's comprehensive financial plan.

Where to start LTC conversations

Despite the confusion about what LTC is, it's encouraging to see from our survey that the majority of people recognize the importance of LTC insurance. This can be the starting point as you connect with clients to help them plan for these potential expenses.

As you consider which clients may be more interested in a long-term care planning conversation, there are some generational differences to be aware of. Among LTC-informed survey respondents (after reading a definition of what long-term care is), 68 percent of those who fall in Generation X (around the ages of 42-57) said having LTC insurance was either very or somewhat important—more than the general population.

As this age group is getting closer to retirement, many Gen Xers may be scrutinizing their current savings and thinking about what their retirement may look like, including the potential for needing LTC. This group is also more likely to be in a place where they're ready to make financial decisions that can help secure their future.

Even though most people are turning to those closest to them to talk about this sensitive subject, you still have an important role to play in these conversations. In our survey, 30 percent of respondents told us they would be open to discussing LTC costs with a financial professional in the future.

Because the need for LTC is a personal topic that comes with many emotional issues, your voice can be the objective view that many clients need to make informed decisions for themselves, their spouses, or their family members.

Holly Snyder is President of Nationwide Life Insurance. In her current role, which she assumed in 2019, she is responsible for all aspects of the life business, including business strategy and execution, managing life sales growth and profitability, product and business development, and fundamentally transforming the life new business processes to optimize the customer experience. Holly believes that life insurance has a noble purpose and her strategic goal is to protect as many people as possible with Nationwide's customer-focused and value-based life insurance solutions.

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https://blog.nationwidefinancial.com/client-outcomes/retirement-income-planning/clarity-is-needed-to-help-clients-plan-for-the-benefits-of-life-insurance-and-long-term-care/

Health Savings Accounts

Jonathan C. Harrington, CFP, MSFP, MST

When it comes to retirement savings, there are many different accounts that offer tax benefits. But most only offer two of the three tax-preferential benefits. For instance, a Roth IRA allows invested money to grow tax deferred and be withdrawn tax-free but does not allow a tax deduction for contributions. On the other hand, a traditional 401(k) plan allows a tax deduction for contributions and grows tax deferred, but the money is taxed upon withdrawal.

Health savings accounts (HSAs) are often referred to as triple tax advantaged because they allow for a tax deduction for contributions, tax-deferred growth, and tax-free withdrawals for qualified distributions.

In this post, we'll review who is eligible to contribute to an HSA and the requirements you need to meet to be able to take advantage of all three tax benefits.

Who can contribute?

There are four main requirements to be able to contribute to an HSA:

1. You must be covered by a high deductible health plan (HDHP) on the first day of the month.
2. You cannot be covered by any other health plan (note that disability, dental, vision, long-term care, and accident insurance do not apply here).
3. You cannot be enrolled in Medicare.
4. No one else can claim you as a dependent on their tax return.

HSAs and Medicare

As mentioned above, you cannot contribute to an HSA if you are enrolled in Medicare.

Be aware that when you file for Social Security, you will automatically be signed up for Medicare (after age 65), so factor in stopping your HSA contributions 6 months before you file. If you forget, this should be caught on your tax return, and you have until the due date (usually April 15 of the following year) to remove the excess contributions and earnings from your HSA.

If you started collecting Social Security before age 65, you must stop your HSA contributions the month before you turn 65, as you will be automatically enrolled in Medicare at age 65. As an example, if you turn 65 in June, your last HSA contribution will be in May, and you can contribute a total of 5/12 of the annual limit.

What is an HDHP?

The IRS sets very specific criteria for health insurance plans to be considered high deductible. Below, we walk through the basic requirements, but when in doubt, ask your insurance carrier whether your plan is HSA eligible. Insurance companies tend to be very in tune with whether plans are eligible, given that it can be such a significant benefit.

First, the plan must have a minimum deductible of $1,500 for 2023 (increasing to $1,600 for 2024) for individual coverage or $3,000 ($3,200 for 2024) for family coverage. Keep in mind that for family plans

with different individual and family deductibles, both deductible amounts must meet these minimum requirements.

The out-of-pocket maximum for the plan, which includes deductibles and copayments but not premiums, cannot exceed $7,500 ($8,050 for 2024) for individual coverage or $15,000 ($16,100 for 2024) for family coverage.

Enrolling in an HDHP doesn't necessarily mean that you will not receive any benefits until your deductible is met. The HDHP can cover some preventive care procedures without disqualifying it for HSA contribution purposes.

How do HSAs work?

Contributions

HSA contributions are typically made through payroll deductions, similar to a 401(k). These deductions are not taxed, will not be included in earnings on your W-2, and do not phase out at any income level. When deducted directly from your paycheck, these contributions also avoid Social Security and Medicare taxes. You can contribute to an HSA on your own and still take advantage of a tax deduction, but you will miss out on these FICA tax savings (an additional 7.65 percent for most!).

There are of course contribution limits to HSAs as a trade-off for the significant tax benefits. In 2023, you are limited to contributing $3,850 (increasing to $4,150 for 2024) for an individual or $7,750 ($8,300 for 2024) for a family.

If you are 55 or older, you can make an additional $1,000 catch-up contribution. And if you and your spouse are both over 55, you can each make an additional $1,000 contribution. Be aware that HSAs are individually held accounts, so a spouse making a catch-up contribution would need to open their own account to do so.

It's important to understand that if your employer makes contributions on your behalf, those contributions count toward these limits. So you want to keep this in mind when deciding how much to have withheld from your paycheck each year.

Excess contributions

If you overcontribute to your HSA in a given year, you may face a 6 percent excise tax for each year that the excess contribution remains in the account.

To avoid this penalty, you'll need to withdraw the amount contributed that was over the limit no later than your tax filing deadline, including extensions, for that year.

For more details on correcting overcontributions to HSAs and other tax-advantaged accounts, take a look at this article.

Tax-deferred growth

After contributing to your HSA, you can start taking advantage of the tax-deferred growth. You can invest the money in your account according to your unique goals and time horizon. Any dividend, interest, or capital gains income that is generated within the account is not taxed in the year it is earned.

And as you'll see later, it may never be taxed depending on when you withdraw the funds and what you use them for.

In order to maximize this tax-deferred growth, if you have the ability to fund your medical expenses with your current cash flow, you can leave the funds in your HSA untouched and invest them for long-term growth. You can even keep track of receipts for expenses you incur today and use them years in the future to pull money out of the account tax-free.

Distributions

If you withdraw money from your HSA and use it for qualified medical expenses, the withdrawal is made completely tax-free. This is the third piece of the triple tax advantage offered by HSAs. Qualified medical expenses include most typical health care costs as well as Medicare premiums and potentially a portion of long-term care insurance premiums.

However, if you withdraw the money and do not use it for qualified medical expenses, the cost can be steep. You'll owe taxes on the withdrawal at your current marginal tax rate and you'll also be hit with a 20 percent penalty.

For example, if you're in the 24 percent tax bracket and withdraw $1,000 for a nonqualified expense, you would owe $240 of income taxes and be charged a penalty of $200.

Distributions after age 65

As you can see from the extensive tax benefits, HSAs are best used for medical expenses. However, there is an additional opportunity to use funds for any purpose and still realize some of the tax advantages.

At age 65, you can withdraw money from your account for any reason, without incurring the 20 percent penalty. You'll still owe income taxes on distributions, unlike if the money were used for medical expenses. But this is a good option for those who have limited medical expenses in retirement and are not expecting to use all their HSA funds for that purpose.

Inheriting an HSA

One disadvantage of HSAs is the tax treatment upon the death of the account owner. An HSA can pass tax-free only to a spouse. If anyone else inherits the account, the entire balance is taxed to that person in the year of inheritance.

So plan to spend your HSA on medical bills during your and your spouse's lifetimes. This is of special importance to the LGBTQ+ community, where couples may not be married, and they need to understand that their HSA cannot be passed tax-free to their partner at death. The account will be fully taxed at death if it hasn't been spent.

Final thoughts

The tax advantages offered by HSAs can have a significant positive impact on your long-term financial picture. Next time you are selecting a health plan, consider whether an HSA-eligible plan could be the right choice for you. And if you want help thinking through the right decision for you and your unique situation, please reach out to our team.

Jonathan C. Harrington, CFP, MSFP, MST, has been providing financial planning and tax advice to individuals and families since 2004. After spending 4 years working as a wealth planning advisor for a regional private bank, Jon transitioned to the public sector for 7 years, providing financial counseling services for families in New York and Massachusetts. Jon joined Milestone Financial Planning in 2016 and became an owner in 2021.

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