Retention of Top-Performing Employees with Loan Split Dollar

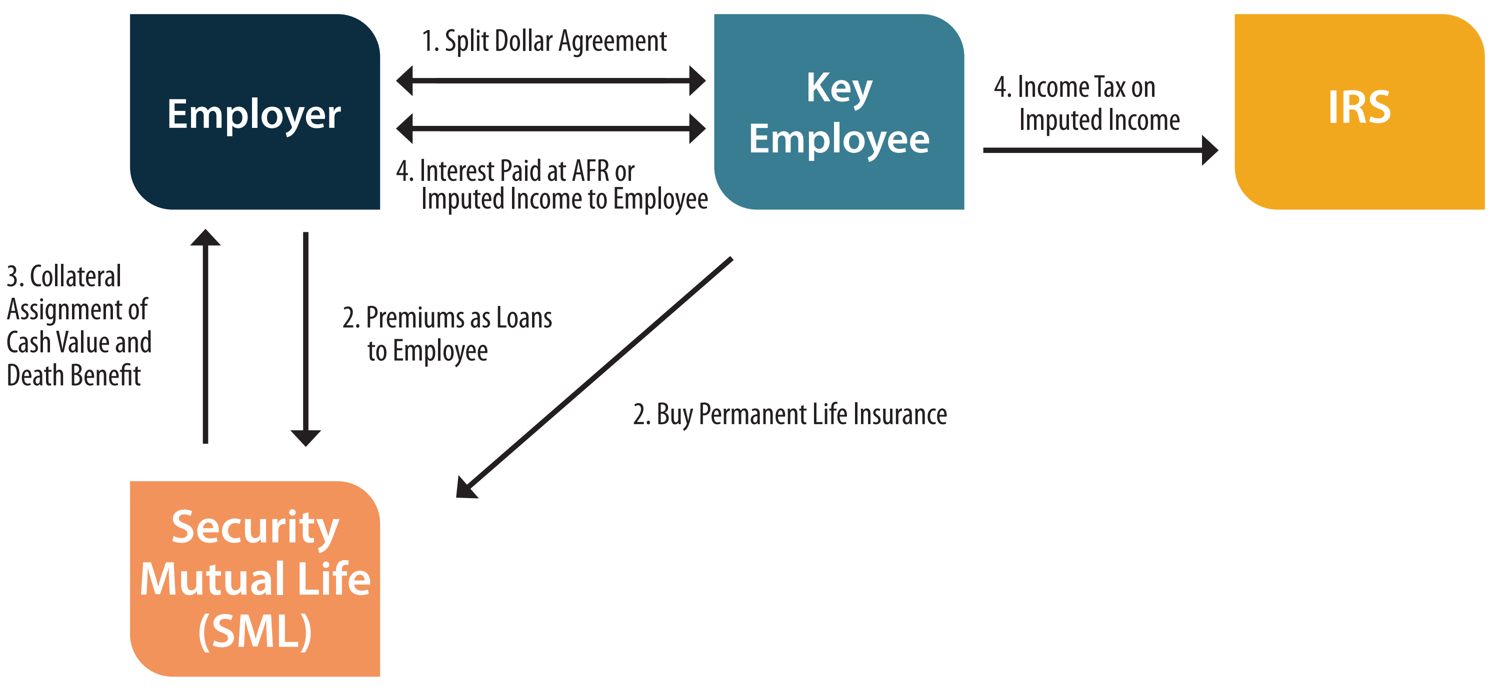
As many successful business owners know, employee retention is one of the biggest concerns in this current tight labor market where skilled workers are hard to find and keep, particularly at the highest levels. Finding a way to entice these top performers to stay with your company and build loyalty should be top-of-mind to all business owners. Top-performing executives and managers are seeking more than just higher levels of compensation. They seek benefits that are special, not available to most employees, useful for their personal planning objectives, and acknowledge their contributions to the company's success. That's why Loan Split Dollar is a popular strategy, particularly in the current low interest rate environment.

Split dollar is a strategy where the main components of a permanent life insurance policy, such as whole life insurance, are "split" between the employer and the employee. Those components are the premium, cash values and death benefit. While split dollar comes in a couple of variations, Loan Split Dollar allows the employee to own a valuable permanent life insurance policy that builds up cash values. The employee can then potentially access those cash values to meet lifetime needs such as funding college education or to supplementing retirement income. The policy also provides a death benefit to protect the employee's family. All of this can occur with the employee contributing relatively little for that benefit.

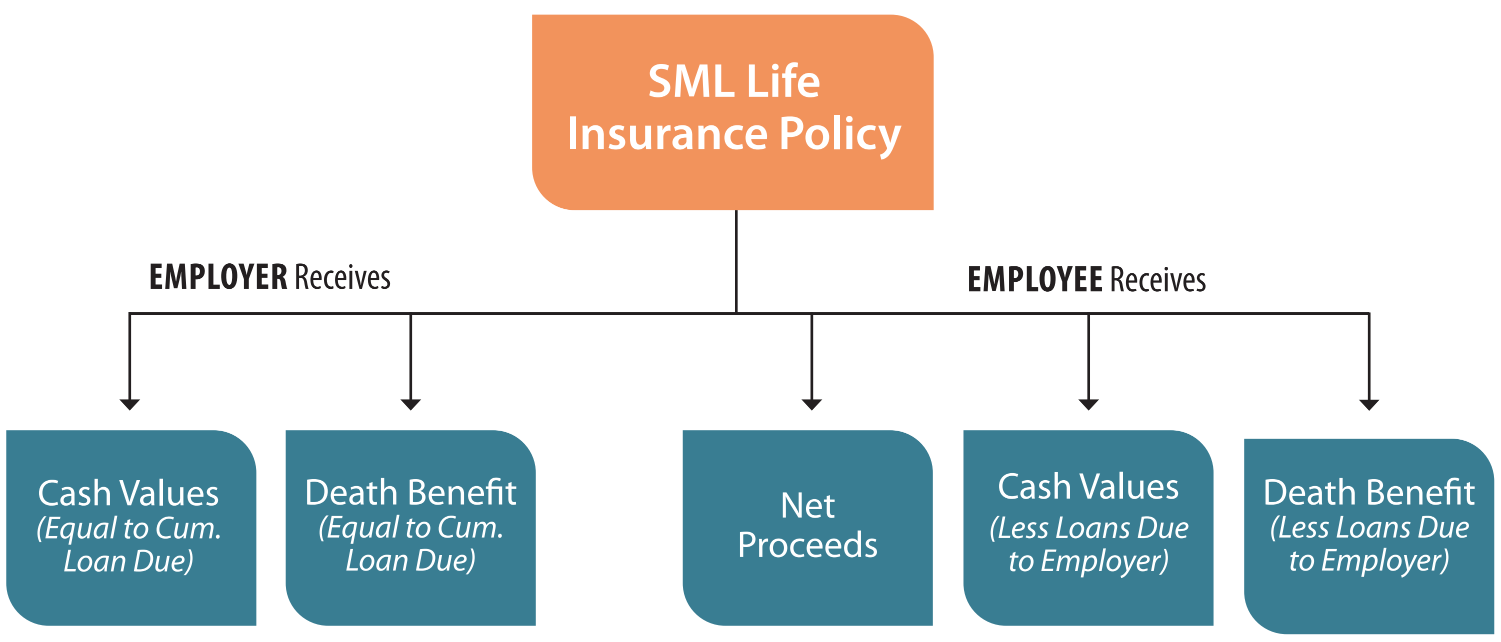
The premiums are paid by the employer as a loan to the employee, secured by a collateral assignment so that the employer can recover the amount lent to the employee down the road. Loan interest is paid by the employee each year at a rate generally dictated by the appropriate Applicable Federal Rate (AFR) that is determined by the IRS each month for various repayment terms. Currently, AFRs remain at historic lows. If loan interest is not paid by the employee, the interest will be deemed imputed income to the employee, and thus subject to income taxes.

Sometime in the future, typically when the employee retires or leaves the company, the employee repays the loan. The source of the repayment could be from the cash value of the policy, resulting in little out-of-pocket expense to the employee for the entire arrangement. Depending upon the performance of the employee, the employer can even forgive the loan, which would be treated as additional compensation to the employee, or the employee can repay the loan from personal funds and assets. If the employee dies before the end of the arrangement, the employer will receive a portion of the death benefit to recover its loaned funds with the remainder going to the employee's family.

Here's how it might work:



The "split" policy will look like this:



In summary, there are significant benefits to the employer and employee from this arrangement.

For the Employee

1. It provides valuable death benefit protection to the employee's family with little out-of-pocket expense. Depending upon the structure of the arrangement, loan split dollar can also be used to fund life insurance that provides estate tax liquidity or to replace wealth lost to taxes.

2. The expense is primarily the payment of the loan interest or income taxes on the unpaid interest, which is treated as imputed income each year.

3. There is access to cash values above the loan repayment amount for lifetime needs.

4. The employee can take the policy, after repaying the loan, when leaving the company and continue the valuable life insurance protection and cash value accumulation using his or her own resources without the need to show insurability.

5. Providing this unique benefit shows how much the employer values the employee and builds loyalty.

For the Employer

1. Loan split dollar is an excellent tool to attract and retain key employees who are vital to the success of the business and to build loyalty.

2. The arrangement allows the employer to recover the loans from the death benefit or cash values, so it is cost-effective.

3. The employer can pick and choose which employees will receive this unique benefit. It is generally limited to select management or highly compensated employees who typically have the skillset and talents that are most difficult to attract and retain.

4. It is relatively simple to administer this arrangement compared to other types of executive benefit programs.

5. For C-corporation shareholder/employees, you can leverage lower taxed corporate income (i.e., 21 percent) for personal permanent life insurance coverage to benefit shareholders in much higher tax brackets (i.e., generally in the 32 percent to 37 percent range).

Conclusion

Loan Split Dollar is one of the most popular executive benefit strategies to attract and retain high-performing, skilled employees. While the concept is fairly easy to understand and apply, the strategy is more complex than described, and that's why you need to work with your business-planning team to determine whether this makes sense for your unique situation. Your Security Mutual life insurance advisor will assemble your team and coordinate with your business-planning attorney and tax professional to review your situation, formulate a plan and prepare the necessary documents to effect the plan.

For More Information Contact:

Contact your Security Mutual life insurance advisor today to get the process started.

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