Legatus Memoria

White Paper

Death Benefit Only (DBO) Plans vs. Split Dollar (S/D) Plans

Plan Parameters:

Financial Institutions sometimes share a portion of the death benefit from Bank Owned Life Insurance (BOLI) plans with the executives to be insured. Historically, Split Dollar (SD) Plans were used to help keep the death benefit tax free to their beneficiaries. The tax code permits up to $50,000 of group life insurance to be tax free without having the executive pay for the Value of Economic Benefit (VEB) on their W2 each year. When more than $50,000 of life insurance death benefit is provided or shared with an executive the VEB is required and the executive pays a small tax to keep the death benefit tax-free.

Split Dollar Plans:

Financial institutions who wanted to share some of the death benefit from BOLI often exceed the $50,000 limit imposed by the IRS VEB rules. Providing a tax-free benefit where the insurance carrier "splits" the benefit between the financial institution and the executive's heir makes sense at face value, but at what cost? Sure the "tax" is about one-third the cost of the executive buying a personally owned term insurance policy, but unlike a term policy, SD plans terminate at retirement or when the executive separates from service from the employer. What is the real cost?

- The executive pays the VEB tax each year.
- The financial institution pays for the accounting of that VEB in order to include it on the W2. This is typically $150/yr. per policy.
- The HR department must update the W2 each year with this VEB.

All of this is done to provide a tax-free death benefit that 99% of the time will never be paid as most executives will die after they retire. The conclusion: this is a time consuming and taxing plan to administer.

Death Benefit Only DBO) Plans:

Simplicity is best. The DBO plan accomplishes the same goal of sharing the proceeds of the BOLI policy but with far less cost and hassle for an unlikely event that would occur prior to their retirement date. So what is a DBO plan really? Think of it as a Wage Continuation Plan. In the event of a death of the executive, the financial institution agrees to pay (by legal contract) some of the money to the survivor. The survivor will have to pay the tax on the proceeds just as if it was earned by the executive. The money can be paid out in a lump sum or over a period of months. The amount to be shared can be "grossed" up to help the survivor pay the tax while being a net neutral cost to the employer. A DBO Plan has a one-time cost to set up the legal document just like an SD plan for each executive but no longer is there a VEB tax to be paid, an annual administration fee to be paid, or time required annually by the HR department to make sure the VEB is correctly added to the W2.

The financial institution can deduct 100% of the proceeds given to the executive's survivor. BOLI is paid 100% tax-free to the corporation.

Here is an example:

BOLI policy with a cash value of $170,000 and a death benefit of $500,000 at the time of a pre-mature death of an executive. The corporation receives $500,000 tax free. The DBO Plan document was set for 1 times salary which for this example was $100,000 at time of death. It is "grossed up" to help the survivor cover the tax which for this example is the 22% personal tax rate. The $128,205 is paid out and deductible by the financial institution. It looks like this:

DBO Plan

$500,000	tax free from BOLI
- 128,205	distributed to survivor ($100,000 after tax at 22% tax rate)
+ 32,051	tax deduction at 25% federal and state corporate tax rate
$403,846	net to the financial institution with a tax-free gain of $233,846

Split Dollar Plan

$400,000	tax-free to corporation for a tax free gain of $230,000
$100,000	tax-free to executive's survivor.

Plus, all the VEB taxes over the years paid by the executive, all the administration expenses accumulated, and all the extra time contributed by the HR dept.

In Summary:

DBO Plans are less expensive and easier to administer when sharing some of the proceeds from BOLI. The DBO Plan may also net more tax-free gain to the corporation.

To learn more contact:

Mark Gurley at 616-451-0783 Mark@GiftCOLI.com