An **Overview Guide**
for Business Owners

Split Dollar arrangements

Strategies for competitive business

Business Strategies Planning

MassMutual FINANCIAL GROUP®

We'll help you get there®

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Key to a successful business

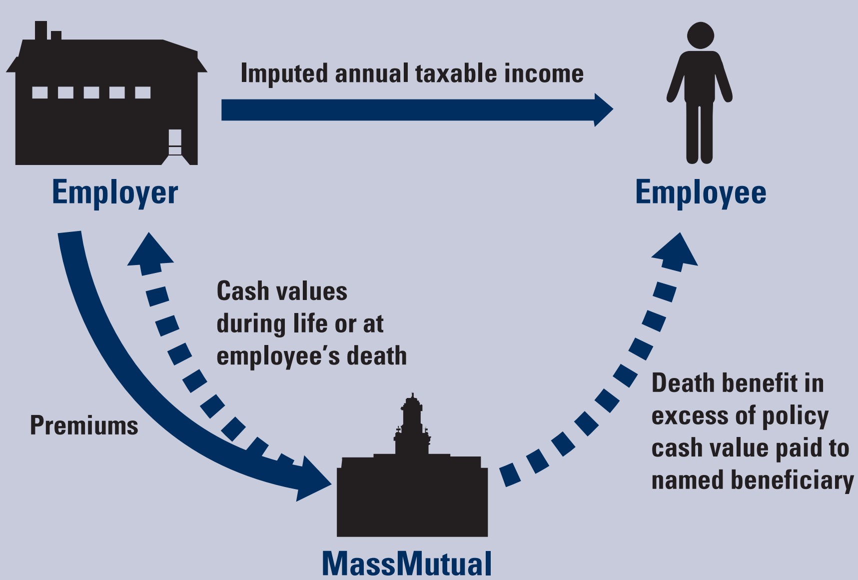
Retention of key employees

If you own a closely held business or are a senior executive at a major corporation, you know the importance of rewarding, retaining and recruiting key employees. Key employees are as important to the success of your business as the product or service you provide.

Split Dollar arrangements can be an advantageous alternative to adding new fringe benefits, increasing compensation or enhancing current incentive programs – all of which increase company overhead. Balancing the impact to the bottom line with the need to retain experienced employees is challenging in today's market.

Split Dollar arrangements can be a win-win for the employer and the employee. They are a cost- and tax-effective way of providing life insurance benefits for selected key employees. The employer pays all of the policy premiums and the death benefit is split between the employer and the employee's beneficiary. Split Dollar arrangements can give your company the versatility to tailor a benefit to the key employees you choose.

Endorsement Split Dollar arrangement



Split Dollar is advantageous for employers and employees

Employer advantages:

- **Selectivity –** You decide who participates and the benefit levels for each employee. Split Dollar gives you the flexibility to choose a group of executives or just one key employee with the versatility to have a different benefit for each.
- **Easy to establish and administer –** IRS approval is not required and administration is minimal.
- **Split Dollar is an asset –** Policy cash values are an asset on the business' balance sheet and the cash value grows on a tax-deferred basis.
- **Cost effective –** Unlike other fringe benefits, the business normally recoups the cost and the death benefit proceeds are normally received income tax free.
- **Leverage –** A Split Dollar arrangement may cost less than the after-tax compensation dollars required to provide an equivalent benefit.
- **Employee productivity and loyalty –** Key employees will feel valued and will be more productive. "Golden handcuff" provisions can be included, giving key employees incentive to remain loyal to the business.
- **Versatility –** Split Dollar arrangements can be used in a variety of ways to meet an executive's or a business owner's estate planning and business needs.

Employee advantages:

- **More meaningful –** The employee enjoys insurance protection when they need the coverage the most.
- **Cost and tax effective –** The employer generally pays the entire premium; the employee is taxed based on his or her share of the death benefit at a very attractive "term" rate.
- **Tax-free death benefit –** Death benefit proceeds are generally received income tax free by the employee's beneficiary.
- **Versatility –** In addition to the financial protection life insurance in a Split Dollar arrangement provides, it can also be designed to help supplement retirement or estate planning needs.

Flexibility and versatility – for a variety of business and personal life insurance needs

- **Employee retention –** Split Dollar arrangements are an excellent fringe benefit providing protection and estate planning advantages above and beyond other benefits for key employees.
- **Estate planning –** When properly structured with third-party ownership, Split Dollar arrangements can be funded using primarily corporate dollars. This provides the executive and/or the business owner with estate liquidity at a low out-of-pocket cost (the income tax on the term value). Combining the arrangement with an irrevocable trust may also keep the death benefit out of the executive/owner's estate. Use of business funds for the premium frees up personal cash for other needs.
- **"Frosting" on group term insurance –** Higher paid employees are subject to income tax on the value of group term benefits in excess of $50,000, making the excess benefits quite costly to the employee. Permanent life insurance can be a very attractive replacement for term benefits and gives the company a much bigger bang from equivalent fringe benefit dollars.

- **Fund cross purchase buy-sell agreement –** Split Dollar arrangements can be a great way to reduce the out-of-pocket costs for the parties to a buy-sell agreement.
- **Supplemental retirement benefit –** At retirement, the employer can roll out the permanent life insurance policy out of the arrangement as a bonus to the employee. The employer receives a tax deduction based on its interest in the policy. The employee receives the life insurance policy free and clear and pays income tax only on the value of the bonus. The employee may then utilize the policy to provide death benefit protection and supplemental retirement income options.
- **Split Dollar and Deferred Compensation –** To use this dynamic duo, the employer and employee enter into separate Split Dollar and Deferred Compensation arrangements. Under a stand-alone Deferred Compensation arrangement, any benefits paid, including pre-retirement death benefits, are taxable income to the recipient. By adding a Split Dollar arrangement, any death benefits paid in excess of the life insurance policy's cash value are generally received income tax free by the employee's beneficiary. For the employer, the policy cash values would be available to meet business needs and ultimately, the employer may recover its costs.

Establishing a Split Dollar arrangement

Split Dollar arrangements are commonly used within an employer-employee relationship. When compared with an IRS qualified benefit program, these arrangements can be much easier to set up and administer. Your financial professional[1] will work with you through the process to minimize your efforts while maximizing the efficiency of your Split Dollar arrangement. At Massachusetts Mutual Life Insurance Company (MassMutual), we are committed to helping you address your business needs.

How permanent life insurance works in a Split Dollar arrangement:

- **Premiums:** The employer pays the premiums. The employee is taxed on the economic value of his or her share of the death benefit. The taxable value is based on an IRS table or the insurance company's applicable one-year term rates.
- **Cash values:** The employer is entitled to all of the policy cash values if the arrangement is terminated before the insured's death. The cash values are reflected on the employer's balance sheet. The employee has no interest in the cash value.
- **Death benefits:** The employer is usually entitled to the greater of the policy premiums or the cash value. The employee's beneficiary is entitled to the balance. By prior agreement, the employer could receive a greater share of the death proceeds.

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[1] There are many alternatives and variations associated with Split Dollar arrangements. Given the possibilities, you can gain great advantage by putting the MassMutual team of advanced sales experts to work for you. Your financial professional will coordinate with your advisors and a team of MassMutual home office professionals to help assure that you implement the right solution to your fringe benefit and estate planning needs.

- **Ownership of the policy:** Basically, the employer, employee, or a third party can own the policy. Third-party ownership is common for estate planning purposes. Regardless of who owns the policy, the employer's share of the death benefits and cash values is protected through the documentation of the Split Dollar arrangement.

Implementation of a Split Dollar arrangement is simple:

- **Identify** and discuss with your key employees.
- **Apply** for the insurance.
- **Design a Split Dollar arrangement:** Taking into account your company's needs and those of the key people you wish to cover, your financial professional can help design the appropriate Split Dollar arrangement for your review. This may involve tailoring benefits to each key employee or a group of key employees or executives.
- **Execute the Split Dollar agreement:** In certain arrangements, you may also need to execute a collateral assignment. To facilitate implementation, MassMutual can provide specimen agreements for use by your advisors. For legal reasons, MassMutual cannot prepare the actual agreements for your Split Dollar arrangements.
- **Termination of the Split Dollar arrangements:** The Split Dollar agreement addresses treatment of the policy if the arrangement is terminated for any reason other than death; e.g., termination of employment or retirement.

Alternative Split Dollar loan arrangement

- Instead of utilizing a traditional Split Dollar arrangement where the employer owns all of the policy cash values and the employee is taxed on the term insurance values of the annual death benefit protection, the arrangement could be established as a Split Dollar loan. Under the loan arrangement, the employee owns the life insurance policy and the employer makes a loan each year to pay all or a portion of the annual life insurance premium.
- The loan can bear interest at the Applicable Federal Rate (AFR), which can be paid, accrued, or the loan can be structured as a below market, no interest loan. Under the below market rate loan rules, the employee is taxed each year on the calculated value of interest that the employee was not required to pay using the Demand Loan AFR as the benchmark interest rate. The employer receives a tax deduction for the below market interest rate value treated as compensation to the employee; the employer is then treated as receiving such amount from the employee as a taxable interest payment.
- All other aspects of the Split Dollar loan arrangement are similar, except that the employer's interest is equal to the outstanding loan rather than the entire cash value. The employer's interest is secured by a collateral assignment rather than through direct policy ownership. Instead of the employee being taxed annually on the term value, the tax consequences with a Split Dollar loan arrangement are based on the below market rate tax rules.

What does it cost?

The cost of a Split Dollar arrangement (the premiums paid) rests on many variables:

- The number of employees covered;
- Their benefit levels;
- The ages, health and in some instances, the employee's occupation; and
- The type of product selected and its long-term performance.

While it is true that the premiums must be paid and the business usually bears most or all of this cost, the *true cost* of Split Dollar is not measured in terms of insurance premiums alone. The employer's share of the policy cash value is an asset on the business' balance sheet. Eventually, this asset may be equal to or greater than the premiums paid by the employer. Moreover, should the insured meet with an untimely death, the employer recovers its cost from the policy's death proceeds. Likewise, if the Split Dollar arrangement is terminated, the employer usually recovers its costs from the policy cash value.

As for the employee, his or her cost is the income tax on the taxable economic benefit. Therefore the employee receives an insurance benefit at a low cost.

The bottom line is that permanent life insurance in a Split Dollar arrangement, uses recoverable business dollars to meet important key employee needs while greatly benefiting the business – which makes Split Dollar a win-win for the employer *and* the employee.

MassMutual. We'll help you get there.®

There are many reasons to choose a life insurance company to help meet your financial needs: protection for your family or business, products to provide supplemental income and the confidence of knowing you will be prepared for the future.

At Massachusetts Mutual Life Insurance Company (MassMutual), we operate for the benefit of our participating policyowners. We stand strong in the fundamental belief that every secure future begins with a good decision. And when choosing a life insurance company – ownership, strength and stability matter.

Learn more at www.massmutual.com/mutuality

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