

A Group Carve-Out Plan

Are you aware that there may be a more advantageous way for your business to provide selected employees, including owner-employees, with large amounts of life insurance protection than through a group term life insurance plan?

Prepared for:

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*Life Insurance, Annuities and
Long-Term Care*

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Advantages and Disadvantages of Group Term Life Insurance

Advantages

- Inexpensive to provide small amounts of coverage to all employees.
- Guaranteed issue may be available.
- Generally easy to administer.
- Amount of coverage usually increases with salary increases.
- Costs are tax deductible by the corporation.

Disadvantages

- Costs can escalate rapidly as average age of employees increases.
- No cash value build-up is available.
- Cannot discriminate in favor of key employees.
- Not portable, unless conversion premiums at attained age are paid.
- Coverage in excess of \$50,000 is imputed income to covered employees.

For key employees with more than \$50,000 of group term life insurance, the **disadvantages** tend to outweigh the **advantages**.

Group Term Life Insurance Example

What Can a Typical Key Employee Expect from a Group Term Life Insurance Plan?

Age: 45
 Annual Salary: \$100,000
 Tax Bracket: 28%
 Group Term Formula: 2 X Annual Salary
 Amount of Group Term Life Insurance: \$200,000

The Results:

Year	Employee's Attained Age	Amount of Group Term Life Insurance	Excess Group Term Life Insurance over \$50,000	Table I Imputed Income	Tax on Imputed Income (28%)	Cash Value Available
1	45	\$200,000	\$150,000	\$270	\$76	\$0
2	46	200,000	150,000	270	76	0
3	47	200,000	150,000	270	76	0
4	48	200,000	150,000	270	76	0
5	49	200,000	150,000	270	76	0
6	50	200,000	150,000	414	116	0
7	51	200,000	150,000	414	116	0
8	52	200,000	150,000	414	116	0
9	53	200,000	150,000	414	116	0
10	54	200,000	150,000	414	116	0
11	55	200,000	150,000	774	217	0
12	56	200,000	150,000	774	217	0
13	57	200,000	150,000	774	217	0
14	58	200,000	150,000	774	217	0
15	59	200,000	150,000	774	217	0
16	60	200,000	150,000	1,188	333	0
17	61	200,000	150,000	1,188	333	0
18	62	200,000	150,000	1,188	333	0
19	63	200,000	150,000	1,188	333	0
20	64	200,000	150,000	1,188	333	0
			TOTALS	\$13,230	\$3,710	\$0

There is, however, a cost-effective alternative to providing large amounts of life insurance through a group term life insurance plan...

A Group Carve-Out Solution

"Carve-out" the portion of group term life insurance coverage provided to selected key employees in excess of \$50,000 and replace it with individual cash value life insurance policies.

A group carve-out plan offers these advantages to your business and its selected key employees:

- **The business can select which employees will be included** in the group carve-out plan and provide them with additional life insurance protection, without disrupting the basic group term insurance coverage provided to all employees.
- **Shareholder-employees** of a closely-held corporation **may utilize a group carve-out plan to benefit themselves alone**, excluding all other employees.
- **The coverage provided to selected key employees through a group carve-out arrangement can be for life**, meaning that high conversion premiums do not have to be paid when the key employee retires or otherwise terminates employment.
- Depending on the group carve-out option selected, **the policy's cash values may be available to supplement the key employee's retirement income** (withdrawals and loans will reduce the policy's death benefit and cash value available for use).
- The **employer's total cost** for the coverage provided to selected key employees **may be less** than if the same coverage is provided through a group term life insurance plan.
- The **key employee's taxable income** arising from the insurance coverage **can be reduced or eliminated**.

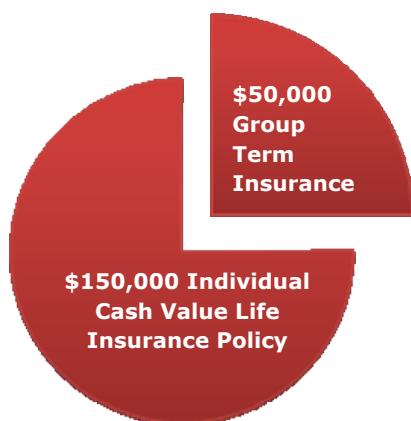
The Mechanics of a Group Carve-Out Plan

The bottom line is that a group carve-out is an effective way to reward selected key employees with substantial life insurance protection provided on a more cost-efficient basis than through a group term life insurance plan.

Here's how a group carve-out plan could work
to *selectively reward and retain your key employees...*

BEFORE THE GROUP CARVE-OUT...

In this example, the key employee has \$200,000 of group term life insurance, \$150,000 of which is taxed to the employee at Table I rates.



AFTER THE GROUP CARVE-OUT...

The employee's group term life insurance is capped at \$50,000, on which there is no imputed income.

The other \$150,000 is provided by an individual cash value life insurance policy funded by the selected plan design option.

Group Carve-Out Plan Design Options

There are **three plan design options** to select from in "carving-out" group term insurance and replacing it with individual cash value life insurance policies.

Option	Advantages	Disadvantages
<p>1. Executive Bonus Plan:</p> <p>Maximizes the employee benefit; retains the deductibility of employer-paid premiums; easiest plan to implement.</p>	<ul style="list-style-type: none"> ■ Premiums are fully deductible by the business. ■ Employee can accumulate substantial cash values. ■ Employee owns the policy. 	<ul style="list-style-type: none"> ■ Premiums are taxable income to the employee. ■ No employer cost recovery. ■ Less "golden handcuffs" effect.
<p>2. Endorsement Split Dollar Plan:</p> <p>Provides the employee with the benefits of permanent life insurance at the cost of term insurance.</p>	<ul style="list-style-type: none"> ■ Can be arranged to produce low or no income tax to the employee. ■ Employer cost recovery. ■ Moderate "golden handcuffs" effect. 	<ul style="list-style-type: none"> ■ Reportable economic benefit increases each year and continues until plan is terminated. ■ Employer's premium payments are not deductible. ■ Substantial cash may be needed by employee to acquire the employer's rights in the policy.
<p>3. Death Benefit Only Plan:</p> <p>Gives the employer total control, while providing the employee with an attractive benefit.</p>	<ul style="list-style-type: none"> ■ Policy's cash values owned by the employer. ■ Benefits are tax deductible by the employer as paid. ■ Employer receives death proceeds free of regular income tax. ■ Maximum "golden handcuffs" effect. 	<ul style="list-style-type: none"> ■ Requires business continuity for promised benefits to be paid. ■ Employer's premium payments are not deductible. ■ Benefits are taxed to the employee's beneficiary as received. ■ Employee has no portability.

Group Carve-Out Plan Action Checklist

Now...

- Select the key employee(s) to participate in the plan, as well as the plan design option(s) to be used, the insurance amounts and, as appropriate, the premium sharing methods and ownership arrangements.
- Select the appropriate life insurance funding vehicle(s).
- Establish each participating key employee's insurability.
- Arrange for payment of premiums, as appropriate to the plan design option(s) selected.

Short-Term...

- Draft and execute the appropriate plan agreement and a corporate resolution authorizing the plan, if appropriate.
- Review the issued policy(ies), verifying that policy ownership and beneficiary arrangements are correct, based on the plan design option(s) selected.

Longer-Term...

- An annual review can help ensure that the plan remains current.
- Evaluate other employee benefit planning needs.

Important Information

The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, VSA, L.P. is not engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

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