

A photograph of a man and a woman walking outdoors on a paved path. The woman, on the left, is wearing a green long-sleeved shirt and light-colored trousers, holding a white coffee cup. The man, on the right, is wearing a grey sweater over a light blue collared shirt and light-colored trousers, holding a blue folder. They are both smiling and appear to be in conversation. The background shows trees with green and yellow leaves, suggesting a park or campus setting. The foreground is filled with out-of-focus red flowers.

Delivering Nonprofit Executive Compensation Through Loan Regime Split Dollar Arrangements

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BY BDO USA AND VANBRIDGE**



In a competitive global economy, the search for talented executives in any industry is challenging. For nonprofits, the competition for experienced professionals is particularly challenging, as the individuals with the required skills may come from the for-profit arena. By way of example, nonprofit healthcare systems struggle to attract and retain skilled physicians and key leadership. Opportunities in nonprofits may be less appealing to highly qualified entrants due to the lack of equity-based compensation.

Compensation for nonprofit officers, directors, and key employees¹ is subject to reasonableness tests and disclosure on IRS Form 990. In addition, the Tax Cuts and Jobs Act (TCJA) of 2017 introduced a 21% excise tax on certain highly compensated executives employed by tax-exempt organizations. Effective for tax years beginning after 2025, the reconciliation tax bill known as the One Big Beautiful Bill Act (OBBBA) expanded the excise tax on executive compensation exceeding \$1 million to include former employees employed in tax years beginning after December 31, 2016, in addition to current employees. This tax regularly becomes problematic for larger nonprofits such as hospital systems and higher education institutions that often have many highly compensated employees.

One way to mitigate these issues is to provide more attractive, tax-deferred benefits to these highly compensated individuals, which can be accomplished through a collateral assignment split dollar (CASD) arrangement.

¹ A key employee is one who is among the top 20 employees receiving reportable compensation in excess of a specific dollar amount announced by the IRS each year and who meets certain responsibility criteria. The IRS adjusts the HCE dollar limit every year, and for 2025, the HCE dollar limit is \$160,000. It is adjusted in \$5,000 increments.



Finding Solutions with a Collateral Assignment Split Dollar Arrangement

A CASD arrangement, also known as a “loan regime” split dollar arrangement, is a compensation strategy used by many privately held for-profit and nonprofit employers to provide attractive benefits to highly compensated executives. Under these arrangements, the employer extends a loan to the executive, which the executive uses to pay for life insurance premiums. The executive is the policy owner, and the organization is named as a partial beneficiary. The loan is structured to comply with IRS regulations and can provide a significant death benefit for the executive as well as cash value to be used as retirement income during the executive’s lifetime.

The tax burden for the executive is typically lower under this strategy because they are receiving a nontaxable loan instead of cash compensation. By structuring the benefit as a loan, the employer is turning a payroll expense into a future receivable. The split-dollar loan to the executive is repaid at death using the life insurance policy death benefit. Any excess death benefit can be payable to the executive’s named beneficiaries or back to the sponsoring company as additional cost recovery above the loan amount. Alternatively, a percentage of any excess death benefits may be split between the executive’s designated beneficiaries and the employer as a shared benefit.

Although publicly traded companies are generally prohibited from making loans to directors and executive officers, so they typically do not use CASD arrangements², the use of CASD arrangements² by nonprofits and private, for-profit companies has significantly increased. There are several reasons for this increase in use:

1. Form 990-Friendly: A CASD arrangement is reported under Form 990's Schedule L, rather than in Part VII. This can improve the perception of the arrangement, because most of the cost to the organization is recoverable and may be less likely to trigger excise taxes under IRC Section 4958 for intermediate sanctions based on the payment of more than reasonable compensation to a disqualified person.

2. Tax Advantages:

- **Employee Impact:** Supplemental executive retirement plans for nonprofits are often subject to Internal Revenue Code Section 457(f), so that the plan benefits are taxable to the nonprofit executive or key employee in the year that they vest, unlike for-profit plans that provide the executive flexibility to defer taxes to future years in which the benefit is received. Correctly designed CASD plans are not subject to
- **Employer Impact:** Since a CASD arrangement helps limit or reduce the nonprofit executive's cash compensation, the excise tax levied on the organization (for compensation over \$1 million) may be reduced or eliminated.

3. Customized and Flexible Benefits:

- **Employee Impact:** Employees are often looking for ways to save more for retirement or better provide for their families, which are typically the primary purposes for a split-dollar arrangement. Even those who do not qualify for favorable life insurance rates on their own due to medical reasons may be eligible for a CASD arrangement. If this benefit is provided on a group basis (insurance carriers offer guarantee issue coverage
- **Employer Impact:** This benefit can be structured with customized vesting schedules to enhance employee retention.

4. Expenses Traded for Receivables: Because nonprofits don't pay federal income tax, the compensation expense deduction the organization is giving up is less valuable than the receivable it gets in return. In other words, a tax-exempt organization is not giving up anything by making a loan to an executive instead of paying current cash compensation. In fact, it can be better for the nonprofit, because when the loan is repaid (for example, after the executive's death), the organization gets money back. This approach is especially beneficial if the executive's pay is over \$1 million, because that extra pay would normally be subject to the 21% excise tax owed by the tax-exempt employer. By using a CASD arrangement, the nonprofit avoids this extra tax.

Section 457(f) and can accommodate a variety of vesting schedules that would not result in taxable income to the executive.

for 10 or more plan participants), life insurance can often be secured with limited or no medical underwriting — a significant advantage for those who might not otherwise qualify for life insurance.

² See Section 402 of the Sarbanes-Oxley Act of 2002, codified as Section 13(k) of the Securities Exchange Act of 1934.

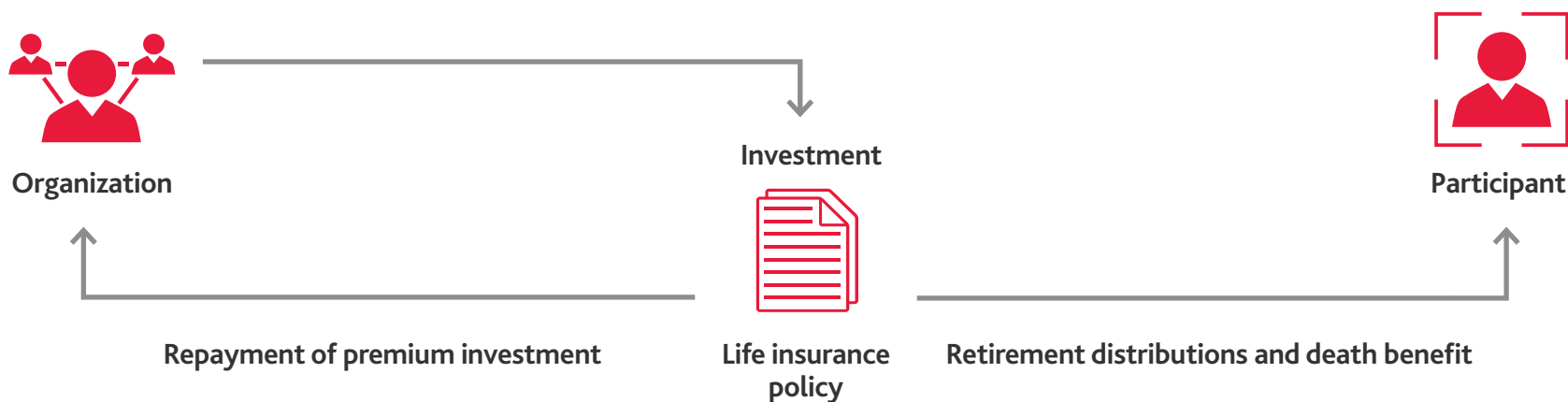


ADVANTAGES TO PARTICIPANT

- ▶ Dedicated to retirement-based program
- ▶ Downside market protection through an Indexed Universal Life (IUL) insurance policy
- ▶ Vested benefits do not trigger income tax

ADVANTAGES TO THE ORGANIZATION

- ▶ Plan is considered non-compensatory
- ▶ Does not create an unfunded liability under IRS reg. 409A, 457(f)
- ▶ Investment structured program with accretive asset on the balance sheet
- ▶ Employer receives cost recovery through tax free death proceeds or access to policy cash values



Maintaining Compliance

When entering into a CASD arrangement, the organization must adhere to IRS regulations governing split-dollar plans. Working with experienced advisors in executive compensation and tax planning can help you navigate these complex regulations, for example, by helping develop proper plan documentation and administration.

Detailed agreements and ongoing monitoring of the plan are necessary to protect both the organization and the executives involved. Engaging legal and administrative professionals experienced in split-dollar arrangements can help mitigate potential risks. For example, it is important to select a life insurance professional who has the institutional structure, processes, and technical knowledge to build a lasting plan.

CASD in Practice

A large nonprofit hospital system was led by a nationally recognized, entrepreneurial CEO. The hospital system competed with the for-profit sector for this leader. In recognition of his service, and, in an effort to retain this key leader, the hospital system planned to pay the executive a \$5 million cash bonus.

However, this strategy would not facilitate the long-term retention of this individual, and would be tax inefficient both for the hospital (which would be subject to the excise tax on executive compensation exceeding \$1 million) and the CEO (who would be taxed at the highest marginal tax rate). This cash compensation would have to be reported on Form 990, placing the executive and hospital at risk for [intermediate sanctions](#) if the IRS deemed the executive's compensation to fail the reasonableness test.

Instead of paying the executive \$5 million in cash, the hospital used a \$20 million split-dollar life insurance policy. This could give the executive access to the economic benefit of the \$5 million if the executive took out a policy loan (which are generally not repaid to the policy). The cash value of the policy grows tax-free inside the policy, and policy loans from the cash value are intended to be taken by the executive as retirement funds. The policy also provides a death benefit for the executive's family (i.e., the value over and above the premium advance, minus any unpaid policy loans taken by the executive). For the hospital, this approach turned a regular compensation expense into an accounts receivable (i.e., an asset), allowing it to recover the full cost.

SIDE BY SIDE COMPARISON OF CASH COMPENSATION VS. SPLIT DOLLAR

	\$5M Cash	\$5M Split-Dollar Loan
Gross Cash Payment	\$5,000,000	\$5,000,000
Excise Tax Cost to Nonprofit¹	\$1,050,000	\$0
Income Tax to Exec²	\$2,000,000	\$0
Net Value to Exec	\$3,000,000	\$5,000,000
Repayment Back to Nonprofit³	\$0	\$5,000,000 + interest
	Spending \$6M to deliver \$3M	Delivering full \$5M value

▶ ¹ Assumes 21% excise tax.

▶ ² Assumes 40% income tax.

▶ ³ Interest on loan can be imputed, paid annually or accrued depending on situation.

Final Thoughts

Nonprofits can leverage CASD arrangements to address the challenges imposed by compensation restrictions and the excise tax on highly compensated executives. By structuring these arrangements to comply with regulations, organizations can provide attractive benefits to their executives, facilitate rewards for performance, and provide a long-term retention tool while maintaining compliance with reasonableness tests and reporting requirements. The flexibility and customization options offered by split-dollar plans make them a valuable tool in attracting and retaining top-tier talent.





BDO AUTHOR

JUDY CANAVAN

STS GES Managing Director

VANBRIDGE AUTHORS

NATHANIEL S. SIEGEL

Managing Principal

Director of Executive Benefits

TYLER HORNING

Managing Principal

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