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Cash value life insurance makes Harbaugh college football's top-paid coach

This type of deferred compensation alternative appeals to talented leaders and executives.

By **Jordan Smith** | November 16, 2016

In August, the University of Michigan announced that it had amended its contract with head football coach Jim Harbaugh to include a creative deferred compensation alternative involving cash value life insurance (http://www.lifehealthpro.com/2013/08/15/the-value-of-cash-value-life-insurance).

The arrangement makes Harbaugh the highest paid college football coach in the country, according to Sports Illustrated and other news outlets.

What most people don't know, however, is that the compensation strategy was designed to provide Harbaugh with millions of dollars of tax-free cash during retirement. It's one that can also be incredibly effective on a much smaller scale.

Related: Here's why cash value life insurance is a superior product (http://www.lifehealthpro.com/2015/02/26/heres-why-cash-value-life-insurance-is-a-superior)

The details of Harbaugh's agreement

When Harbaugh was originally hired at Michigan, the parties had agreed to sit down and discuss the establishment of a deferred compensation package (http://www.lifehealthpro.com/2015/01/16/nonqualified-deferred-compensation-plans-what-are) after the end of his first season. What they ultimately agreed to, however, will likely prove to be much more valuable.

Instead of a Deferred Compensation Agreement, Harbaugh and Michigan entered into a Split-Dollar Loan Agreement under which the University agreed to make seven loan advances, of $2 million each, that would be used by Harbaugh to pay premiums on a life insurance policy.

As long as the policy remains in force, the loan will not have to be repaid until Harbaugh dies, at which time, Michigan will recoup its original $14 million investment, and Harbaugh's beneficiaries will receive the remainder of the death benefit. While some news reports have stated that Harbaugh's beneficiaries are guaranteed to receive at least 150 percent of the amount due back to the University ($21 million, once the full loan has been extended), the actual terms of the "Loan Agreement" only require that the residual death benefit (net of the loan) be at least $1,120,000 following Harbaugh's attainment of age 70.

Related: Not all life insurance loan provisions are created equal (http://www.lifehealthpro.com/2016/07/14/not-all-life-insurance-loan-provisions-are-created)

In the meantime, the Loan Agreement allows Harbaugh to borrow money out of the policy (tax-free) as long as the policy continues to meet certain sustainability requirements immediately following the loan.

Some of the finer details of the arrangement have not been made public. These include such particulars as:

- The exact life insurance product being purchased;

- Harbaugh's medical underwriting; and
- Harbaugh's plans for taking cash out of the policy.

But it is possible to get a rough estimate of the economic benefit Harbaugh can expect to receive from the contract by making a few basic assumptions.

Michigan Wolverines head coach Jim Harbaugh watches during an NCAA college football game against the Maryland Terrapins in Ann Arbor, Mich., Saturday, Nov. 5, 2016. (AP Photo/Paul Sancya)

An advisor's perspective

At Schechter Wealth, the product we would propose is an indexed universal life insurance (http://www.lifehealthpro.com/2016/09/12/6-advantages-of-indexed-universal-life-insurance) policy, structured to maximize cash growth.

Related: 10 advantages of term life insurance (http://www.lifehealthpro.com/2016/07/17/10-advantages-of-term-life-insurance)

Assuming that Harbaugh qualifies for preferred medical underwriting (which seems a reasonable assumption, given his well-documented physical activity), he could get a policy with an initial death benefit of $35.6 million, which could grow to as much as $49.3 million by the time all premium payments have been made.

We then project that he could begin taking $1.4 million per year out of the policy, income-tax free; beginning at age 66 and continuing all the way through age 98 (should he be fortunate enough to live so long).

At the same time, his heirs would receive a residual death benefit (net of the amount owed back to the University) that reaches as high as $35.3 million — if he dies after all premium payments have been made, but before he begins taking cash from the

policy — and then gradually reduces as he draws money out of the policy until it drops to the minimum of $1.3 million following the final distribution of $1.4 million at age 98 (after having pulled $46.2 million out of the policy tax-free).

The only income tax that Harbaugh will pay on the transaction is a tax on the "imputed loan interest" that the University is not charging him. That will be calculated based on a minimum interest rate set by the IRS. This imputed interest rate will vary as the rate that applies to each premium advance will be the rate that is then in effect for the month in which that premium is paid. But the current low interest rate environment provides a tremendous opportunity to keep Harbaugh's income tax cost to a minimum.
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Although there are clearly other, non-tax, factors at play, the University could eliminate all variability by advancing the entire $14 million up front and locking in today's low interest rate of 1.9 percent (September 2016). This would generate annual taxable income to Harbaugh of $266,000, which equates to just under $127,000 in combined Federal, State and Affordable Care Act tax at today's rates.

Useful, multipurpose strategy

Insurance-based solutions, like the one used to provide Jim Harbaugh with millions of dollars of tax-free cash in retirement, are not just limited to high-profile football coaches. For example, we recently designed and helped implement a remarkably similar transaction that will provide a 55 year-old executive currently making around $250,000 per year with $100,000 per year tax-free during retirement. The strategy provides the employee with the equivalent of a deferred compensation plan that pays roughly $150,000 per year, while costing the employer noticeably less than that. It can also strengthen the relationship between the employer and the key employee, and provide incentive for the key employee to remain with the employer until retirement.

Editor's Note: Schechter Wealth had no involvement in Jim Harbaugh's contract or the use of insurance and investment products to create his specific program.

See also:

What does "wealthy" mean? (http://www.lifehealthpro.com/2015/11/10/what-does-wealthy-mean)

9 tips: Using life insurance to protect affluent client assets (http://www.lifehealthpro.com/2016/07/08/9-tips-using-life-insurance-to-protect-affluent-cl)

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