



DEFERRED COMPENSATION PLAN



Retirement Planning
Strategies for Small to
Mid-sized Businesses



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Retirement Planning Issues

- Retirement planning is crucial for both business owners and executives
- Social Security and company pensions may not provide enough retirement income



Retirement Planning Needs

- Executives looking for another tax-deferred way to supplement retirement income
- Supplemental retirement planning strategies help businesses attract and retain key employees



Who Is Eligible?

- Under Employee Retirement Income Security Act (ERISA), eligible participants fall under what is known as the “top hat group”
- “Top hat group” is loosely defined as a “select group of management or highly compensated employees”
 - They have higher than average salaries relative to other employees
 - They represent a small percentage of overall employees, usually less than 10%



Who Benefits?

- Small to midsized business owners
- Employers who want to recruit and retain key executives
- Companies that don't offer qualified retirement plans
- Companies that want to offer benefits in excess of those offered by their qualified retirement plans
- Key executives



American Jobs Creation Act of 2004

- Section 409A added to Internal Revenue Code addressing Nonqualified Deferred Compensation (NQDC)
- New law tightens rules for NQDC arrangements
- Offers clear guidelines in designing and administering plans
- Incorporates guidelines for income to be subject to a “substantial risk of forfeiture” (allowing for tax-deferral status)



Here's How It Works

- Executive must elect to defer:
 - nonbonus compensation no later than the end of the immediately preceding tax year
 - performance-based bonuses, which must be based upon a period of at least 12 months, at least six months before the end of the 12-month performance period
- Employer may promise supplemental income at retirement for executive and his/her family
- Employer uses deferred compensation to purchase a life insurance policy on the life of executive



Here's How It Works (Cont.)

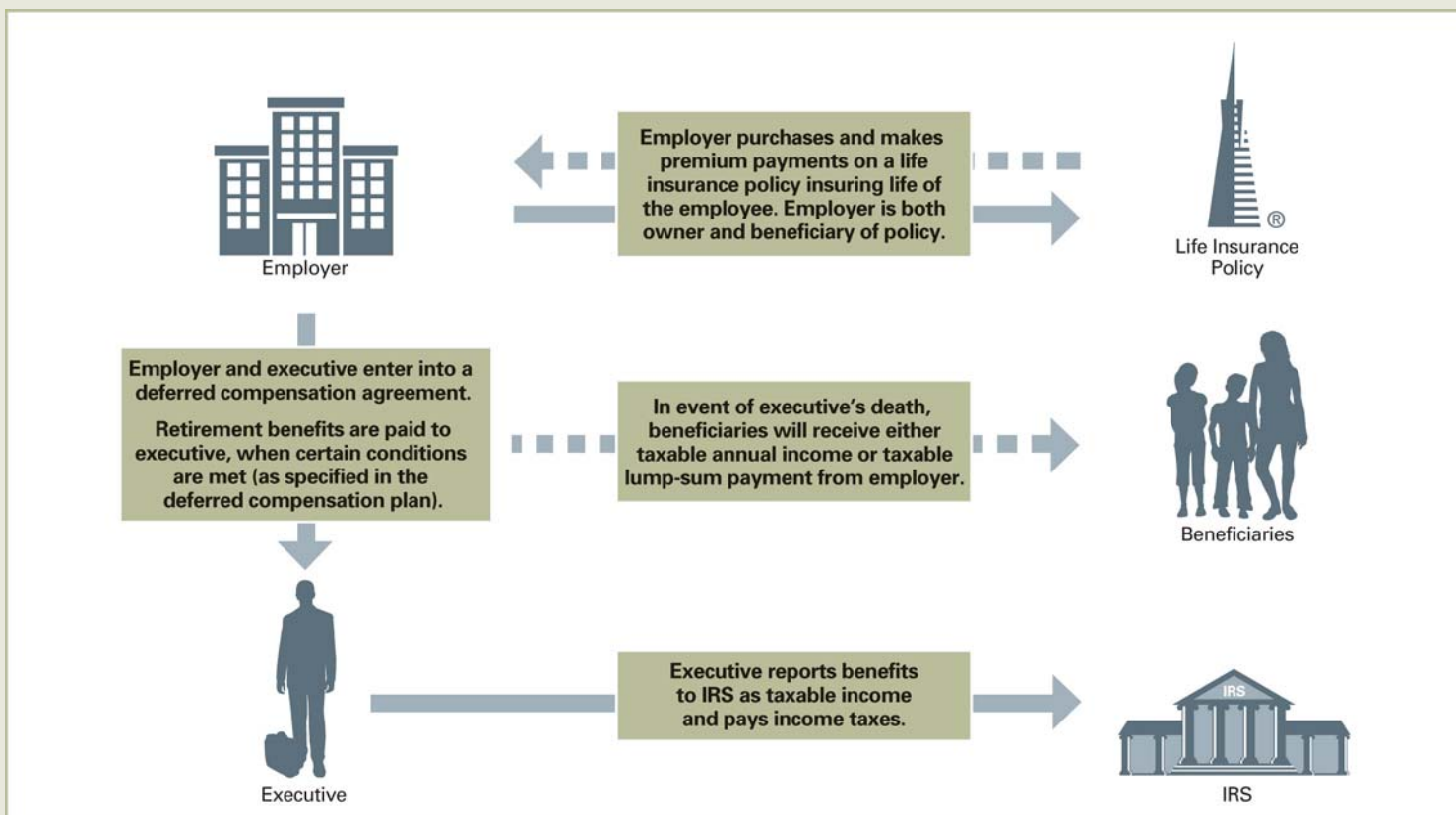
- Employer owns policy and names itself as beneficiary; the executive is the insured*
- Tax-deferred cash value accumulates for employer

This is a typical technique for deferred compensation. There are other, more sophisticated techniques that can be used in some scenarios

** The death benefit above premiums paid will not be taxable under IRC 101(j) as long as written Notice and Consent is obtained prior to policy issue and certain other requirements of such section are met.*



Here's How It Works (Cont.)





Receiving Income

- At retirement or another specified date per formal plan document, executive receives deferred compensation
- Employer can use accumulated cash value to fund deferred compensation distributions*
- Employee is not taxed until income is distributed*

** Withdrawals, performance, and loans will affect the policy value, surrender value, and death benefit. If an amount withdrawn is more than the free withdrawal amount in a policy year, any applicable surrender charges will also be assessed on the excess amount withdrawn. If the policy is a modified endowment contract, loans and withdrawals may be subject to taxes and penalties.*



Receiving Income (Cont.)

- Employer receives tax deduction when benefits are paid out
- Employer receives death benefit from life insurance policy; employee's beneficiaries may receive a taxable death benefit from the employer



Employer Advantages

- Minimal setup costs
- Minimal ERISA requirements
- Provides selected employees with attractive supplemental retirement benefits
- Helps distinguish company's compensation package
- Benefits are tax deductible when deferred compensation is paid to employee*
- Offers benefit flexibility

* *Must be considered reasonable compensation to qualify for tax deduction.*



Executive Advantages

- Reduces taxable income during deferral years
- Taxable death benefit protection to loved ones
- Additional source of retirement income
- Deferral opportunities not subject to qualified plan limits and penalties
- Accumulates tax-deferred cash value until distributed as income
- Can include a pre-retirement survivor benefit



Summary

- Supplements Social Security and company pensions using life insurance
- Provides an essential part of an executive compensation package
- Benefits small to midsized business owners and companies that don't offer qualified retirement plans



Summary

- Enhances executive benefits and may help employers recruit and retain key associates
- Offers tax-advantaged cash value and death benefit protection of life insurance