



A Dynamic Duo: Meeting Nonqualified Deferred Compensation & Key Employee Insurance Needs With a Single Life Insurance Policy

As a closely-held business owner, you understand the critical importance of attracting and retaining key employees. You are searching for a benefits program that will provide the golden handcuffs necessary to tie a key executive to your business and allow you to recover the cost of the program. You also realize that the premature death of a valuable employee will have a significant negative effect upon your company. You'd like to implement a plan that would provide financial support to your business should a key executive die. How do you accomplish both in a cost effective manner?

The Solution – Meeting Nonqualified Deferred Compensation and Key Employee Insurance Needs With a Single Life Insurance Policy

Non-Qualified Deferred Compensation (“NQDC”) arrangements are one of the most common and attractive plans for businesses seeking to reward and retain their top performers because they are flexible and customizable to the executive. Due to its tax advantages life insurance is the most appropriate funding device for a NQDC plan. The company will be the owner and the beneficiary of a policy on the life of the key executive.

NQDC plans come in two basic forms. The first is often referred to as a “Supplemental Executive Retirement Plan” or SERP. A SERP is an agreement where the business promises to supplement the executive’s income at retirement. This arrangement is negotiated and can be customized for each key executive. The arrangement is documented by a written contract. The assets from which the payments are made are held entirely by the business. When the executive retires, the payments made to the executive by the business are taxable to the employee but deductible by the business. The second form of

NQDC plan is commonly referred to as a “Salary Reduction/Deferral Plan.” As the name implies, the executive defers his or her own salary that he or she could have received currently. The salary amounts deferred are not currently taxable to the executive, but will be at retirement and then deductible by the business.

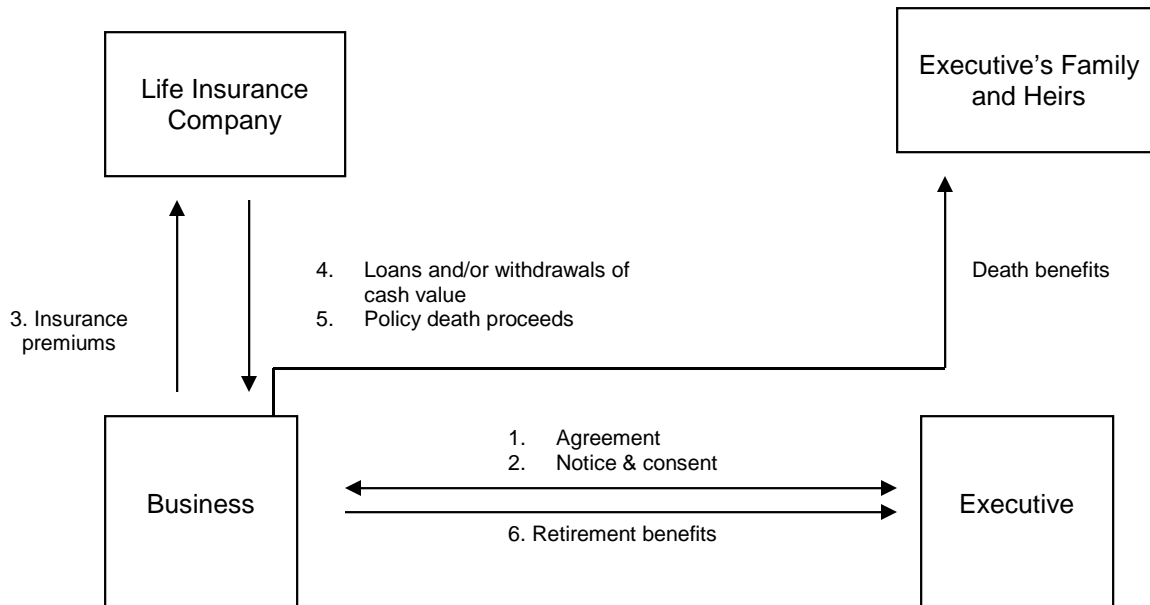
Key Employee Insurance is designed to help protect a business from the financial losses which inevitably occur when a key employee dies or becomes disabled. The amount of insurance coverage required will vary according to many factors. Some of those factors include: effect of the death or disability of the key employee on the potential loss of revenue and profits; business debt obligations, the repayment of which could be adversely impacted by the employee’s death or disability; the cost to hire and train a replacement for the key employee; or some multiple of the key employee’s present salary.

NQDC & Key Person insurance programs both generally utilize life insurance that the company owns on the life of the employee. Implementing both plans with just one life insurance policy per employee may be more cost effective. The company may simply calculate the death proceeds necessary to fund the pre- retirement death benefit under the NQDC plan. To that figure the business will add the monetary value of the key employee to the company. The sum of those numbers will be the life insurance face amount appropriate for use in both programs.



Executive Benefits

How Does It Work?



1. The business and executive enter into an agreement where the business agrees to provide specified retirement benefits.
2. The business provides the executive with the proper notice required by law, and obtains consent that the business can and will take out a life insurance policy on the executive. The business also provides notice of the plan to the U.S. Dept. of Labor, Employee Benefit Security Administration. There are some IRS reporting and record-keeping requirements.
3. Although a business is not required to set aside assets to pay future retirement benefit payments, many businesses choose to “informally” fund their benefit promise through the use of a business owned permanent life insurance policy. This also provides a level of “comfort” to the executive that the benefits will be paid. The business is the applicant, owner, beneficiary and premium payor of a life insurance policy on the executive’s life.
4. The business has a choice of how to cover the cost of paying the executive’s retirement benefits. Policy cash values can be utilized via loans and/or withdrawals to make the required payments. Alternatively, the business can pay the benefits from current cash flow and cost-recover the benefit payments.
5. In the event that the executive dies before reaching retirement, the business receives the policy’s death benefit income tax-free and pays survivor benefits to the executive’s designated beneficiaries. These payments are deductible by the business and reportable as taxable income to the beneficiaries. The death proceeds above and beyond those intended for payments to the executive’s family are utilized by the company to indemnify the loss of the key employee.





Executive Benefits

6. Upon the executive's retirement, the employer makes retirement income payments according to the terms of the agreement. These payments are taxable income to the retired executive and tax deductible by the business.

Advantages

To the Company:

- Flexibility to decide who is allowed to participate
- Ability to attract new talent and retain current executives
- Coordinates with existing qualified plans and can be individually tailored to complement other benefit programs
- Benefits are tax deductible to the business when paid at retirement
- Policy cash surrender value subject to business control
- Tax-deferred accumulation and high early cash value can offset hit to earnings charges
- Two options for cost recovering benefit payments

- Provides the business with a source of funds at exactly the moment it is needed, when a key employee dies or becomes disabled, to pay off loans, hire a replacement, meet expense obligations, etc.
- Banks, creditors and valued partners can be assured that the business will continue uninterrupted in the event of the insured's death or disability.

To the Executive:

- No current income taxation and ability to reduce taxable income
- Tax-deferred growth on account balances
- Increased retirement income
- Pre-retirement death benefit for designated beneficiaries
- Retirement income shortfall can be reduced or eliminated

Note: Life insurance's death benefit is reduced by a loan, loan interest and/or withdrawals. Dividends, if any, are affected by policy loans, loan interest, and/or withdrawals. Withdrawals above what is paid into the policy may cause ordinary income taxes to be paid on the gain portion of the policy. If the policy lapses, any withdrawals or loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), there are no loans and any distribution is considered a withdrawal. These withdrawals are distributed as gain first and subject to ordinary income taxes. If the insured is under 59 1/2 the gain portion of the withdrawal is subject to a 10% tax penalty.

The foregoing information regarding personal, estate, charitable and/or business planning techniques is not intended to be tax, legal or investment advice and is provided for general educational purposes only. Neither Guardian, nor its subsidiaries, agents or employees provide tax or legal advice. You should consult with your tax and legal advisor regarding your individual situation.





Executive Benefits

Please consult with your Guardian Financial Representative if you have any questions concerning this document.

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