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Jason M. Woodward, J.D.
Financial Services Professional
Lowell, MA
financialattorney@gmail.com

How Non-Qualified Deferred Compensation Plans Can Help Businesses Attract and Retain Key Employees

In today's job market, a good salary may no longer be enough to lure or retain key employees. In many cases, it comes down to what "extras" a company has to offer. Some companies focus on helping their employees balance personal and professional responsibilities by offering such perks as flex time, on-site daycare, dress-down work attire, gym membership, personal concierge services, and the like. Other companies focus on financial incentives, like stock options or pension plans. However, when it comes to the competitive market for high-level employees and executives, companies might have to go even further. A non-qualified deferred compensation agreement may be the right incentive for joining a company or staying with a company in the face of another offer.

What Is a Non-Qualified Deferred Compensation Plan?

Simply put, a non-qualified deferred compensation plan is a written legal agreement between an employer and employee(s) in which an employee benefit is provided that generally supplements or substitutes for the retirement benefits available under qualified plans such as pensions or 401(k)s. Unlike qualified plans, there are very limited government regulations involved with non-qualified deferred compensation plans, which means that such agreements can be extremely flexible — with regards to money amounts, payment triggers, etc. — and advantageous to both employer and employee.

Some non-qualified deferred compensation agreements allow for an employee or owner-employee to defer a portion of current compensation — either as a reduction in current salary or a deferral of a raise or bonus, both of which could lower the employee's tax bracket. In exchange, the employer provides an unsecured promise to pay compensation at some predetermined date or event, such as retirement. Other types of non-qualified deferred compensation agreements are called Supplemental Employee Retirement Plans (SERPs). In a SERP, the employer agrees to provide retirement, disability or death benefits to a key employee in addition to current compensation.

Who Benefits from a Non-Qualified Deferred Compensation Plan?

Actually, both employer and employee can benefit from a non-qualified deferred compensation plan. For the employer, the greatest benefit is that it can help recruit, retain and retire key people. Next, unlike qualified plans, a non-qualified deferred compensation plan allows the employer to pick and choose participants, which means it may discriminate in favor of highly compensated executives (including the owner-employee). There is also minimal IRS, ERISA and other government regulatory requirements, and the employer receives a tax deduction when the benefits are eventually paid. Not only are

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non-qualified deferred compensation plans flexible, they are flexible with controllable costs. And they can help augment existing qualified retirement plans.

Similarly, there are many benefits to the employee. An offer of a non-qualified deferred compensation plan to an executive shows recognition and appreciation for his or her contributions to the success of the business. Furthermore, a non-qualified deferred compensation plan can help supplement existing retirement benefits or provide for family if death occurs prior to retirement. Perhaps the greatest benefit, though, is tax deferral. Employees offered non-qualified deferred compensation plans are usually highly compensated — which means that they are near or at the top of their tax bracket. A properly constructed non-qualified deferred compensation plan may allow an employee to pay lower income taxes on current compensation, because the deferred compensation is not counted in current income. And when the deferred compensation is paid, the employee will probably be in a lower retirement tax bracket.

Using Life Insurance to Fund a Non-Qualified Deferred Compensation Plan

In order to achieve these intended tax results, a non-qualified deferred compensation plan must be "an unsecured and unfunded promise to pay benefits." That means that no corporate assets can be tied directly to the plan or put beyond the reach of the employer's creditors. There are a number of ways to fund non-qualified deferred compensation plans; many companies "informally" fund through the vehicle of company owned permanent life insurance. A policy is bought on the life of the employee, but the policy is paid for and owned by the company, and all benefits would be payable to the company. The company could access[1] the policy's cash values to provide some of the retirement benefits to the employee during his or her lifetime, or use proceeds from the policy to pay a death benefit to the employee's family (if those were the terms of the non-qualified deferred compensation plan).

Consult Your Advisors

In order to receive the greatest tax benefits from a non-qualified deferred compensation plan, and to ensure its legality, it is crucial that such a plan is designed by an attorney. When used properly, a non-qualified deferred compensation plan could be a very useful tool in a company's hiring and retention strategy. Such plans are flexible, easy to understand and administer, and can be beneficial to both employer and employee.

For more information on how insurance and other financial solutions can fit into your overall financial plan, contact **Jason M. Woodward, J.D.** today at (603) 264-7550 or financialattorney@gmail.com.

[1] Loans against your policy accrue interest at the current rate and decrease the cash value and death benefit by the amount of the outstanding loan and interest.