CLEARPOINT ADVISORS, LLC

Providing Clarity and Confidence in Insurance, Investment and Benefit Solutions

Volume 10, Issue 3

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News in Brief: Market Update

Special points of interest:

- **Converting legacy plans to a more cost-efficient option**
- **Flexible voluntary benefit options**
- **Multiple deferral periods to manage benefit security**

Deferred Compensation: The Future Revisited

The executive benefit landscape has changed dramatically. Changing philosophies, cost assumptions, and legislative changes have changed the corporate mission towards executive benefits.

- ✓ Options for dealing with legacy plans
- ✓ Provisions for participants waiving frozen plans for more cost effective approaches with less impact on earnings
- ✓ New flexible nonqualified cafeteria plan designs for providing a deferred compensation offering

The future of executive benefits is unfolding. Deferred compensation is still an effective benefit offering. Components of long-term benefits will continue to be needed in the total compensation package to compete for talent.

In addition to providing qualified plans to employees, many business owners implement nonqualified alternatives in order to supplement retirement benefits.

These selective benefit plans are generally offered to key employees and owners. One popular nonqualified benefit is deferred compensation.

Basically, nonqualified deferred compensation refers to an arrangement between an employer and an employee in which compensation for current services is postponed until some future date or the occurrence of a future event. The effect is to postpone taxation for the employee until compensation is received - usually at retirement or disability.

Type of Deferred Compensation

Deferred compensation plans can be categorized several different ways. Plans can be either *funded* or *unfunded*, forfeitable or nonforfeitable, defined benefit or money purchase. They can also provide one or a combination of death benefits, disability benefits and retirement benefits.

Funded plans generally involve a nonqualified trust fund, custodial account or escrow account where the employer transfers money to its “promise to pay” deferred compensation at a later date. These are not very popular as the participant may be deemed to have “constructive receipt” of such funds and, therefore, inherit a current tax liability when funded.

A deferred compensation plan is not regarded as funded merely because the corporation purchased and owns a life insurance policy or annuity contract to make certain that funds will be available when needed.

A typical *unfunded* deferred compensation plan is one where the employee has no guarantee that future payments will be made. If the employer defaults in making promised payments, becomes insolvent or files bankruptcy, the employee simply becomes a general creditor.

Rabbi Trusts

The rabbi trust protects an executive from an employer’s future unwillingness or inability to pay promised benefits of deferred income taxation.

- **A SERP can be an attractive long-term retention tool**
- **SERP can be a better answer than issuing stock**

Deferred Compensation: The Future Revisited (cont.)

The IRS has stated in a series of private rulings that an irrevocable trust or an escrow account can be established to fund a deferred compensation agreement as long as the assets placed into the rabbi trust remain subject to the claims of general creditor. If this condition is met the employee will not be deemed to have "constructive receipt" of the assets, and, therefore, will not have received a current economic benefit. Hence, the employee will not be required to pay taxes until the payments are made at a future date.

Upon the death, disability or retirement of the employee, employer pays the promised benefits to the employee or designated beneficiary.

Various types of compensation and benefit arrangements have developed for top-management employees that may be funded through life insurance. In a deferred compensation agreement a key employee is promised a fixed income for a specified period following retirement.

Arrangements can provide for payments to be made to an employee in the event of disability, or to the employee's spouse (or other beneficiary) if he or she should die prior to retirement.

The corporation finds life insurance attractive because it is able to hold the key employee since the deferred compensation arrangement is normally contingent on continued employment.

<u>Supplemental Executive Retirement Plans</u>

A supplemental executive retirement plan is an arrangement where an employer agrees to pay additional income to an employee upon death, disability or retirement.

<u>Advantages to SERPs</u>

The advantage to the employee of receiving the income after retirement is that normally he or she will be in a much lower tax bracket than if he or she received the benefit currently.

- ✓ The employee is not taxed on income earned until some time in the future.
- ✓ The employer can selectively choose the participants of the plan.
- ✓ Benefits can be designed as "golden handcuffs" to encourage a key employee to continue to work for the employer.
- ✓ Most employers can provide unlimited benefits in place of, or in addition to, those receivable under tax-qualified pension or profit sharing plans.

Clearpoint Advisors has the experience and administrative capabilities to make the design options for a client highlighted above a reality.

Let us bridge your legacy programs to your delivery going forward.

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Source: The Heritage Financial Group and Term Life America