ADVANCED MARKETS

WHICH EXECUTIVE COMPENSATION PLAN SHOULD I CHOOSE?

Your clients want to attract, reward, and retain the best employees. After all, talent and hard work make the business successful. But which is the right one for your clients? While there are many ways to creatively compensate executives, we often see three types: executive bonus, split dollar and nonqualified deferred compensation.

Executive Bonus Plan:

The simplest executive compensation plan is the executive bonus plan. With this plan, the business pays the life insurance premiums on behalf of the valued employee, who owns their own policy. At the end of the year, the amount paid on behalf of the employee is taxable income to them but is deductible by the business as compensation. While this plan offers simplicity and immediate deductibility for the employer, it generally lacks a golden handcuff provision (although we can discuss a restrictive endorsement in a future post). For this reason, some may choose a different path.

Split Dollar Plan:

For some employers, a split dollar plan may fit the bill. These plans are very flexible — they can be structured under the economic benefit regime where the employee is taxed annually on the value of the death benefit protection (and other benefits), or as a loan to the employee for a personally-owned policy. Either way, the business will eventually recover the amounts it pays on behalf of the employee. This can be an excellent choice for those that want minimal immediate tax consequences to the employee and allows for cost recovery by the employer.

Nonqualified Deferred Compensation Plan:

There are a number of employers that value control over all other considerations. They want to encourage productive behaviors and longevity from their top employees. They can do so by establishing a deferred compensation plan with their top hat employees. This allows them to set specific conditions upon which the compensation is earned, and require that the employee work until some date in the future to vest in the plan. It is important to note that deferred compensation is not deductible to the business immediately (since it is not includible in the employee's income until then), rather when it is paid to the employee upon vesting. Further, there are a number of requirements that must be made a part of the written deferred compensation agreement, so they can be more challenging to implement and administer.

Which is the best plan?

The best plan depends on your client's priorities. Each has its own benefits and drawbacks, so it is important to really understand what is most important to your clients and what best supports their compensation strategy. Start by asking what they want to protect and what is most important — immediate tax deductions, flexibility and cost recovery or maximum control. The best plan will emerge from there.

Call us in Advanced Markets if we can help.

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