

# GUIDE FOR A COMBINATION PLAN

## Key Person - Split Dollar - Deferred Compensation

---

Asset Exchange Strategies (AES) offers you this three policies-in-one plan to help you understand how life insurance can be used to help provide funds for executive compensation arrangements.

### Do you identify with the following?

#### You are a business owner who:

- Has business loans that cannot be negotiated without your personal guarantee or that of one or more of the business owners; or
- Relies on one or more executives for generating the bulk of the business revenue or for acquiring most of the company's new customers; or
- Depends on a few key executives for the management of your business; and
- Business would be severely affected by the death of a key employee; and
- Desires to provide an incentive that will help retain key executives and have the cash flow necessary to fund the incentive program.
- Key executives have a strong need for death benefit protection for their families and also need to accumulate more funds for future retirement needs.

For more information and free consultation contact your AES Advisor:

866.683.5228 Toll Free

512.528.0801

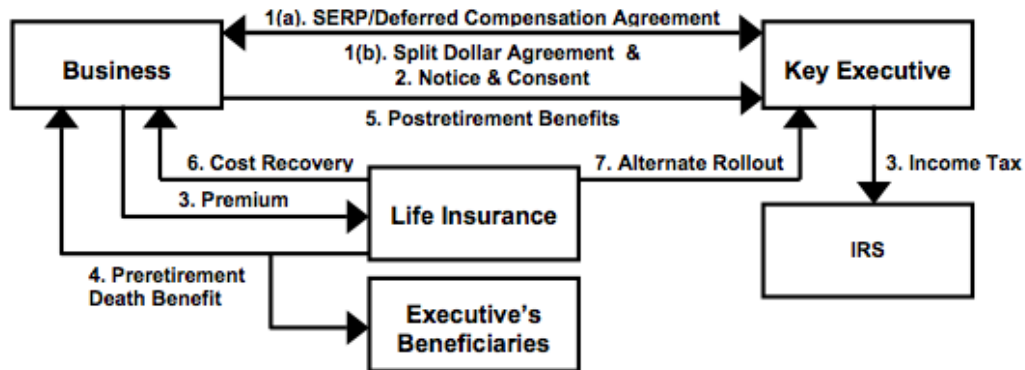
**If so, you may want to consider combining the purchase of key person coverage with both a split dollar arrangement and a deferred compensation arrangement.**

- A combination key person, split dollar, and deferred compensation arrangement:
- Allows the business to protect itself from the financial losses associated with a key executive's death, and
- Is a cost-efficient way to meet an executive's need for a pre-retirement death benefit and postretirement supplemental income with a single life insurance policy?



Key Person - Split Dollar - Deferred Compensation

Key Person, Split Dollar & Deferred Compensation Combination



- The executive and the business enter into two separate written agreements:
  - a SERP/deferred compensation agreement, and
  - a non-equity endorsement split dollar agreement.
- The business gives notice to the key executive that insurance will be purchased on the employee's life and receives consent from the employee. The business purchases a life insurance policy on the key executive's life. The face amount of the coverage is split according to the terms of the split dollar agreement.
- The executive and the business pay premiums according to the terms of the split dollar agreement.
- The executive reports any economic benefit as taxable income.

*If the key person/executive dies prior to retirement:*

- Pursuant to the split dollar agreement, the business and the key executive's beneficiaries receive their respective portions of the death benefit.

*If the key person/executive lives to retirement:*

- The split dollar agreement is terminated. The business pays the executive the supplemental

For more information and free consultation contact your AES Advisor:  
 866.683.5228 Toll Free  
 512.528.0801



## GUIDE FOR A COMBINATION PLAN

### Key Person - Split Dollar - Deferred Compensation

---

retirement benefits pursuant to the SERP agreement. If the executive dies during this payment period, any remaining payments are paid to the executive's beneficiaries.

7. Policy cash values may be accessed by the business to help provide the promised supplemental retirement benefits, or the plan costs can be recovered at the executive's death.
8. Alternatively, if the executive has a continued need for the death benefit at retirement, the executive can negotiate with the employer to have the policy "rolled out" through a purchase or bonus.

#### Benefits to the Business:

- An incentive for executive retention is provided by an attractive benefit backed by a binding agreement.
- Complete discretion is given to the employer as to which employees to include.
- The employer effectively has "golden handcuffs" on the executive since the executive must sacrifice valuable benefits if he/she leaves the employer.
- The key person insurance coverage helps the business to protect itself from the losses it may suffer as a result of a key executive's death.
- If properly structured, this is a flexible benefit program unencumbered by ERISA or nondiscrimination requirements.
- Individually designed incentive programs may be set up with benefits and costs designed to meet the unique needs of each executive and the business.
- The business benefits from cost efficiency because one policy is used to cover several needs. In addition, the arrangement can be structured to enable recovery of the employer's cost at the insured's death, resulting in lower overall costs.

For more information and  
free consultation contact  
your AES Advisor:

866.683.5228 Toll Free

512.528.0801



AssetExchangeStrategies.com  
IRATraining.com  
MyRealEstateIRA.com  
AESFranchise.com

# GUIDE FOR A COMBINATION PLAN

## Key Person - Split Dollar - Deferred Compensation

---

### Benefits to the Executive:

- The key executive receives pre-retirement life insurance protection at a lower out-of-pocket cost than if purchased on an individual basis.
- While the split dollar agreement is in effect, the executive's beneficiaries receive the protection provided by life insurance death benefit proceeds.
- If the executive requires death benefit coverage during retirement years, the policy can be purchased from the employer, or the employer can bonus the policy as a compensation reward for loyalty and service to the business. This provides protection against future insurability problems for the executive.
- The executive receives post retirement supplemental income as provided under the deferred compensation agreement entered into with the employer.
- Unlike qualified plans, no federal income tax penalties are imposed on deferred compensation benefits paid before age 59½.

For more information and free consultation contact your AES Advisor:

866.683.5228 Toll Free

512.528.0801

### Tax Considerations:

- No IRS approval is required for the arrangement; however, the deferred compensation arrangement must be filed with the Department of Labor within 120 days of plan inception.
- Premiums paid to purchase the life insurance on the executive's life to help informally fund the arrangement are not tax-deductible by the business.
- Each year the endorsement split dollar arrangement is in effect, the executive must report income equal to the "economic benefit" received less any amount the executive has contributed. The value of the economic benefit depends on the date the split dollar arrangement is entered into, the type of insurance policy (single life or survivorship



# GUIDE FOR A COMBINATION PLAN

## Key Person - Split Dollar - Deferred Compensation

---

coverage), and whether the arrangement is equity or non-equity split dollar arrangement.<sup>4</sup>

- Subject to the test for reasonableness, nonqualified benefits are deductible to the business and included in the executive's taxable income in the year actually or constructively received.
- Life insurance policy loans are generally not taxable. Withdrawals are generally not taxable to the extent they are a return of cost basis; however, withdrawals that cause a reduction in death benefit in the first 15 years of the policy may be subject to taxation. In addition, for policies that are MECs, distributions (including loans) are taxable to the extent of income in the contract, and an additional 10% federal income tax penalty may apply. If a policy lapses or is surrendered with an outstanding loan prior to the death of the insured, there is taxable income to the extent of income in the contract. Withdrawals and loans will reduce policy cash values and death benefits, may affect any guarantee against lapse, and may have tax consequences.
- For employer-owned life insurance policies issued after August 17, 2006, IRC §
- 101(j) provides that death proceeds will be subject to income tax; however, where specific employee notice and consent requirements are met and certain safe harbor exceptions apply, death proceeds can be received income tax-free. Life insurance proceeds are otherwise generally received income tax-free under IRC § 101(a). This includes the death benefit received under the split dollar arrangement, while any survivor benefits payable to the executive's heirs under the SERP plan are taxed to the heirs as ordinary income.
- If the business is a C corporation subject to alternative minimum tax (AMT), life insurance death proceeds and annual increases in policy cash values may impact the calculation of adjusted current earnings.
- When establishing a deferred compensation plan in conjunction with a split dollar

For more information and  
free consultation contact  
your AES Advisor:

866.683.5228 Toll Free

512.528.0801



## GUIDE FOR A COMBINATION PLAN

### Key Person - Split Dollar - Deferred Compensation

---

agreement, care must be taken to avoid the split dollar agreement being viewed as a dedicated pre-funding of the deferred compensation agreement (raising the possibility that the employee could be currently taxed on the value of such pre-funding amount).

- Therefore, this arrangement should be established only with the counsel of the legal and tax advisors of the business and the executive.
- The Sarbanes-Oxley Act makes it a crime for publicly traded companies to, directly or indirectly; enter into a loan with certain directors and officers. It is unclear whether the Act applies to split dollar arrangements. Clients should consult their tax advisors for the most recent developments.
- Internal Revenue Code § 409A provides that all amounts deferred under a nonqualified deferred compensation plan for all taxable years will be includible in gross income to the extent they are not subject to a substantial risk of forfeiture and were not previously included in gross income, unless specific requirements addressing distributions, acceleration of benefits, and benefit election requirements are met. Failure to comply with the requirements will result in current income inclusion as well as penalty and interest charges. You should consult with your own tax and legal counsel as to the application of these rules before implementing a nonqualified deferred compensation plan.

For more information and free consultation contact your AES Advisor:

866.683.5228 Toll Free

512.528.0801



AssetExchangeStrategies.com  
IRATraining.com  
MyRealEstateIRA.com  
AESFranchise.com