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Nonqualified deferred compensation (NQDC)

An alternative for key employees at their 401(k) limit

Because your business is your life

Your challenge

You may offer a qualified retirement plan for employees, but your key employees[1] may want to contribute more money than the federal limits allow. Plus they may be interested in lowering their current income taxes, in exchange for a future retirement benefit.

A potential solution

A nonqualified deferred compensation (NQDC) strategy using life insurance could be the retirement income solution your key employees need. It provides:

- A promise to pay future retirement benefits
- A way for key employees to reduce their current taxable income by deferring some of their current salary

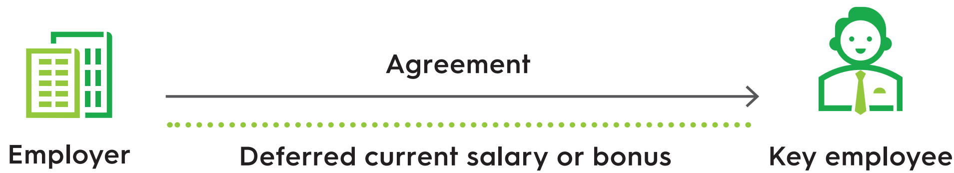
Why is life insurance an ideal tool for this strategy?

With the executive's consent,[2] cash value life insurance can be an excellent resource for accumulating funds for paying future obligations:

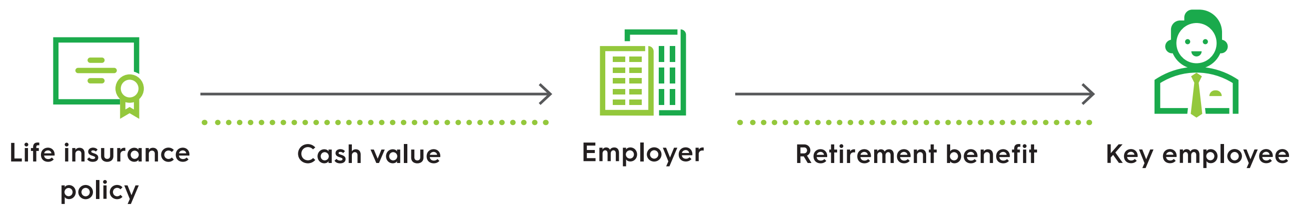
- Your company is the owner and beneficiary of the life insurance policy. The key employee is typically the insured but has no rights or ownership in the life insurance policy
- The premiums you pay into cash value life insurance policies can grow tax free
- Your company doesn't need to rely on business assets or cash flow to pay retirement benefits. Through withdrawals and loans, your company may choose to pay the promised benefits out of the policy's cash value on a tax-preferred basis
- If held until the insured dies, the policy's death benefit is paid to your company tax-free

How does NQDC work?

1. You and your key executive implement an agreement that's drafted by a licensed attorney, specifying:
   - The time at which the key employee can elect to defer compensation
   - The circumstances under which deferred compensation will be paid to the key executive (i.e., separation of service, death, disability, financial emergency, change of control of employer or specified date)



2. You are free to use any source to informally fund your obligation to pay future retirement benefits to the key executive. These sources include company assets, cash flow or company-owned life insurance.



Company benefits	Key employee benefits
• Possible retention of key employees by providing retirement benefits funded primarily by them • You control which employees can participate • Future retirement benefit is determined by both you and the key employee in the agreement • You can vary the benefits depending on the employee • Life insurance can provide a tax-free death benefit to the company that can be used for survivorship benefits and cost recovery, if the employee dies while the policy is in effect	• Reduces current taxable income • Contributions to the NQDC plan are not subject to qualified plan limits • Defers income taxes from the company bonus or salary

Company considerations	Key employee considerations
• No current income tax deduction • More administration than other executive compensation strategies; a company may need to engage a third-party administrator • Owner may need to increase premium payments to keep the policy from lapsing • Cash value withdrawals reduce the policy's death benefit and surrender value; if the policy lapses, amounts withdrawn or loaned (in excess of premiums) could be taxable	• Future retirement benefit is considered taxable income when received • Company may not be around at time of bonus payout • All bonuses are subject to company creditors • May not have a need to defer income taxation

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Family doesn't have to branch from your tree, but it always shares your roots. Roots woven by common understanding, shared values and mutual respect. Those who believe a rewarding life is really about being present in the here and now, and that your financial picture should support the everyday moments as much as the major milestones. That's why our insurance, investment and retirement solutions give you the confidence to focus on what's truly valuable: banking memories with those who matter most.

Learn more

Want to ensure the ongoing success and growth of your business? Contact your financial professional today to find out how you can implement a NQDC strategy.

1. Key employees must be either highly compensated employees or management.

2. A life insurance policy informally funding the NQDC plan is subject to the notice and consent rules for employer-owned life insurance (EOLI). Failure to comply with those rules will subject any death benefit paid to the employer to income tax.

Please keep in mind that the primary reason to purchase a life insurance product is the death benefit.

Life insurance products contain fees, such as mortality and expense charges (which may increase over time), and may contain restrictions, such as surrender periods.

Policy loans and withdrawals may create an adverse tax result in the event of lapse or policy surrender, and will reduce both the surrender value and death benefit. Withdrawals may be subject to taxation within the first fifteen years of the contract. You should consult your tax advisor when considering taking a policy loan or withdrawal.

This information should not be considered as specific tax/legal advice. You should consult your tax/legal advisor regarding your own specific tax/ legal situation.

If a policy is overfunded and becomes a modified endowment contract, the contract's earnings will be taxed as ordinary income at withdrawal, and may be subject to a 10% penalty if withdrawn before age 59½.

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