You Can Attract and Retain Key Employees

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If you have ever run a closely held business or worked with senior executives at a large corporation, you know key executives and employees are the lifeblood of an organization. Good executives are extremely valuable. Of course, you also know that key executives and other employees are in high demand; recruiters are constantly trying to poach your best people.

IS A RETIREMENT PLAN ENOUGH TO RETAIN KEY EMPLOYEES AND EXECUTIVES?

Sometimes a 401k, 403b or other retirement benefit isn't sufficient to retain a key individual. You do have other compensation options — some of which are tax deductible — life insurance, for example.

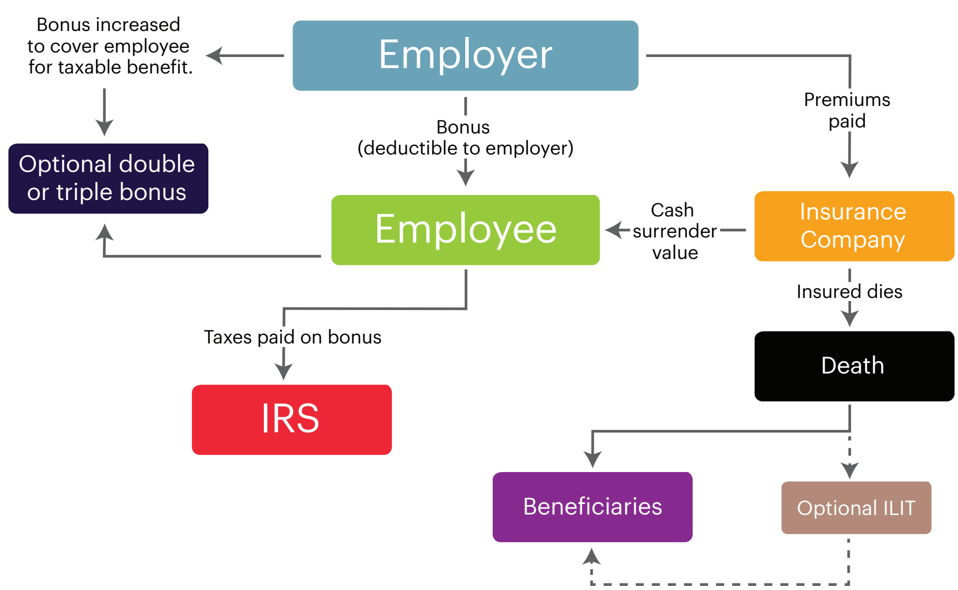
HOW CAN LIFE INSURANCE BE USED TO PROVIDE ADDITIONAL EMPLOYEE BENEFITS?

Premiums on group term life insurance, also known as a § 79 Group Term Life Insurance Plan (Section 79 Plan), are tax deductible to the employer or payor. If the plan is nondiscriminatory, the first $50,000 of insurance coverage is a tax-free benefit to the employee. Travel, accident and health insurance policies do not qualify. If the plan is discriminatory — that is, not offered to all employees — premiums paid by the employer are taxable to the employee receiving the benefit. To avoid the tax obligation, the plan should be structured as nondiscriminatory and adhere to the nondiscrimination rules that govern its tax deductibility. If the plan is intended to be discriminatory, there are better bonus plans to consider. You'll want to layer additional bonus plans on top of the § 79 Plan, thereby providing a tax-deductible benefit to all employees as you provide additional benefits to some.

DID YOU KNOW YOU CAN SET UP A PLAN THAT COMPENSATES ONLY A FEW KEY PEOPLE?

The § 162 Executive Bonus Life Insurance Plan (Section 162 Plan) allows businesses and nonprofits to bypass the nondiscrimination rules that apply to many other types of benefits such as a 403b or 401k. Section 162 plans are relatively simple in structure. An executive or shareholder-employee applies for the life insurance and names a beneficiary to a permanent policy on their own life. They own the insurance, so this is an extremely flexible benefit. Life insurance premiums are paid by the corporation or nonprofit. Payments can be made directly to the insurer or the bonus can be paid directly to the employee. The benefit is treated as compensation for tax purposes and is deductible for the business. Many times a company will also compensate the employee for the additional tax. It's also possible to compensate as a triple bonus — where tax is paid on the tax. In this scenario, the benefit is designed as a zero-tax bonus. The main point of the § 162 Executive Bonus Life Insurance Plan is exemption from the administrative reporting and nondiscrimination rules that apply to many other types of plans.

SECTION 162 EXECUTIVE BONUS LIFE INSURANCE PLAN



DID YOU KNOW YOU CAN PROVIDE ADDITIONAL BUSINESS TAX-DEDUCTIBLE LIFE INSURANCE BENEFITS TO EVERYONE IN YOUR COMPANY IN ADDITION TO PROVIDING EXTRA BENEFITS TO KEY EMPLOYEES OR EXECUTIVES?

You can coordinate the § 162 Plan with a § 79 Plan. Under the § 79 Plan, the qualifying deductible business expense and tax-free benefit to the employee is limited to $50,000 coverage. But you can carve out the § 79 and provide additional coverage on a discriminatory basis as an executive bonus. This is referred to as a § 79 Executive Carve Out Bonus Plan. Under this type of structure, the key employee or executive receives a permanent, individual life insurance policy in addition to the $50,000 in group term coverage and has access to the tax-free buildup of the cash surrender value in addition to the other perks that come with life insurance. The cash value can be accessed for policy loans and withdrawals.

WHAT ARE ADDITIONAL CONSIDERATIONS FOR THE KEY EMPLOYEE OR EXECUTIVE?

Because the life insurance is owned by the insured, there could be estate tax considerations for the high-net-worth employee. If the beneficiary of the policy is the insured's estate, the policy could balloon the estate value at a bad time. If the estate exceeds the Estate and Gift Tax Basic Exclusion amount — $11.4 million in 2019, $22.8 million for married couples due to portability and the unlimited marital deduction — this could lead to the proceeds being taxed at the maximum estate tax rate (40 percent in 2019). An executive or employee who exceeds these thresholds should consider third-party ownership of the policy. An Irrevocable Life Insurance Trust (ILIT) would be a potential solution for the ownership of the policy. In this case, if the rules are followed, the life insurance would be excluded from the decedent's estate. In this case, the insured would need to transfer the life insurance policy to the ILIT. Furthermore, the insured would have to live for at least three years from the date the policy is transferred. Otherwise the proceeds are includable in the decedent's estate. When the policy is transferred to the ILIT by the insured, premiums that have been paid are taxable to the executive or employee and are a gift to the beneficiaries of the trust. The premiums paid then gifted to the ILIT are eligible for the annual gift tax exclusion amount ($15,000 in 2019). It's important to note that beneficiaries must be given withdrawal rights to qualify for the gift tax annual exclusion.

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Mark Matos serves as a senior financial advisor in the Naples, Florida, office of HBKS® Wealth Advisors. He provides comprehensive financial planning services and investment management strategies to affluent individuals and families. Along with having his own financial advisory clients, Mark works with Christopher Sorce in the Naples office.

Mark began his financial services career in 2006 as a portfolio manager with a large regional bank. In 2009, he began working at Global Wealth Consultants as managing director and chief investment officer. He joined HBKS® in 2016 after Global Wealth Consultants merged with the firm.

Mark earned his Bachelor of Arts degree in finance and computer information systems from the Florida Gulf Coast University. He is a CERTIFIED FINANCIAL PLANNER™, a Chartered Life Underwriter® and a Chartered Financial Consultant®.