Business planning

Nonqualified deferred compensation plan (NQDC)

The concept

Your business clients know that once they've secured top talent, it's important to keep those individuals happy. One way to show them they're appreciated is with a nonqualified deferred compensation plan (NQDC) funded with life insurance.

Benefits

With a nonqualified deferred compensation plan, the employer gives the key employee the opportunity to save for retirement through salary deferrals, company contributions or a combination of both. It's both a recruiting and a retention tool for employees who are specialized or valued, and it has less administration and fewer filing requirements than qualified plans subject to ERISA.

NQDC plans offer flexibility in plan design to meet specific needs, and if informally funded with life insurance, the corporation, as the beneficiary, will receive the death benefit, which can be used to recover costs associated with the plan.

Tax considerations

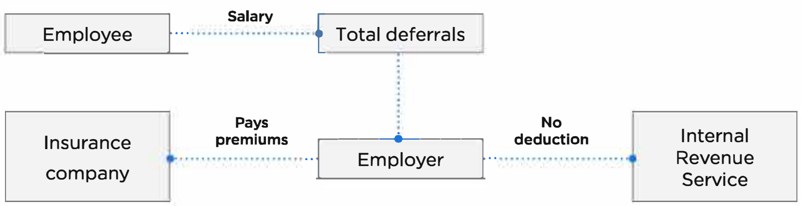
- There is no immediate tax deduction for the employer
- The business gets to take a tax deduction when an employee receives distributions from the plan, and these are taxed as ordinary income to the employee
- There's no impact on existing qualified retirement plans — you can have both a qualified retirement plan and an NQDC plan

Steps

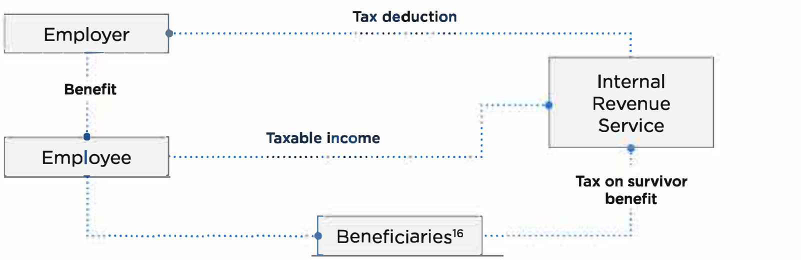
- The employer puts the plan in place, and salary deferrals (and possibly employer contributions) begin
- The employer may choose to purchase life insurance on some or all eligible employees to informally fund the plan; life insurance enables the employer to avoid taxable gains on the plan assets
- The plan uses contributions to fund the life insurance premiums
- Upon a qualifying event, such as retirement, disability or separation from service, benefits are paid to the employee

How it works

Pre-retirement deferral cash flow diagram



Post-retirement benefit cash flow diagram



[16] If the employee dies during post-retirement distribution (or pre-retirement employment), there may be distributions payable to the employee's beneficiaries and taxed accordingly.