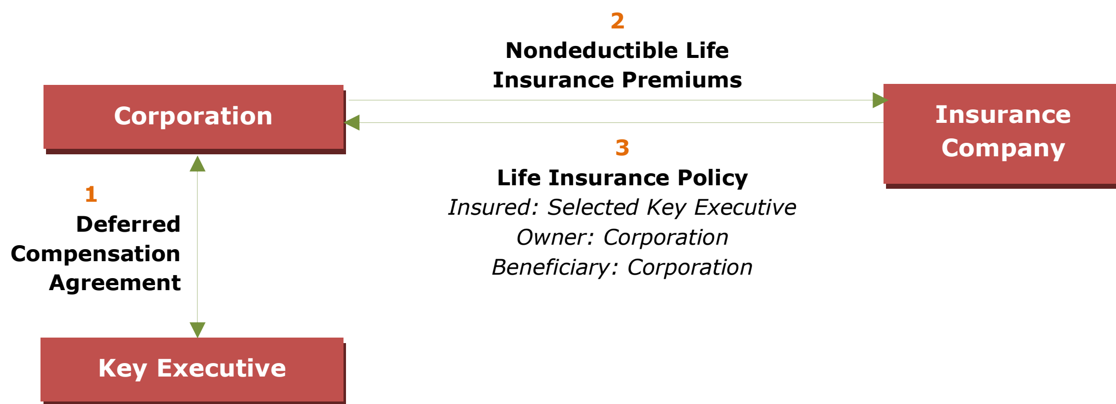
Deferred Compensation Plan in Action

Here's how a deferred compensation plan could work for your corporation and selected key executives today...



1. The corporation enters into a deferred compensation agreement with each selected key executive. The agreement spells out the benefits to be provided if the executive fulfills certain conditions, such as remaining with the corporation until retirement.

2. After satisfying the notice and consent requirements for employer-owned life insurance contracts, the corporation purchases sufficient insurance on the key executive's life to fund the after-tax cost of promised benefits and, if desired, to recover its nondeductible premium costs.

3. The life insurance policy is owned by the corporation, which pays the premiums and is named beneficiary.

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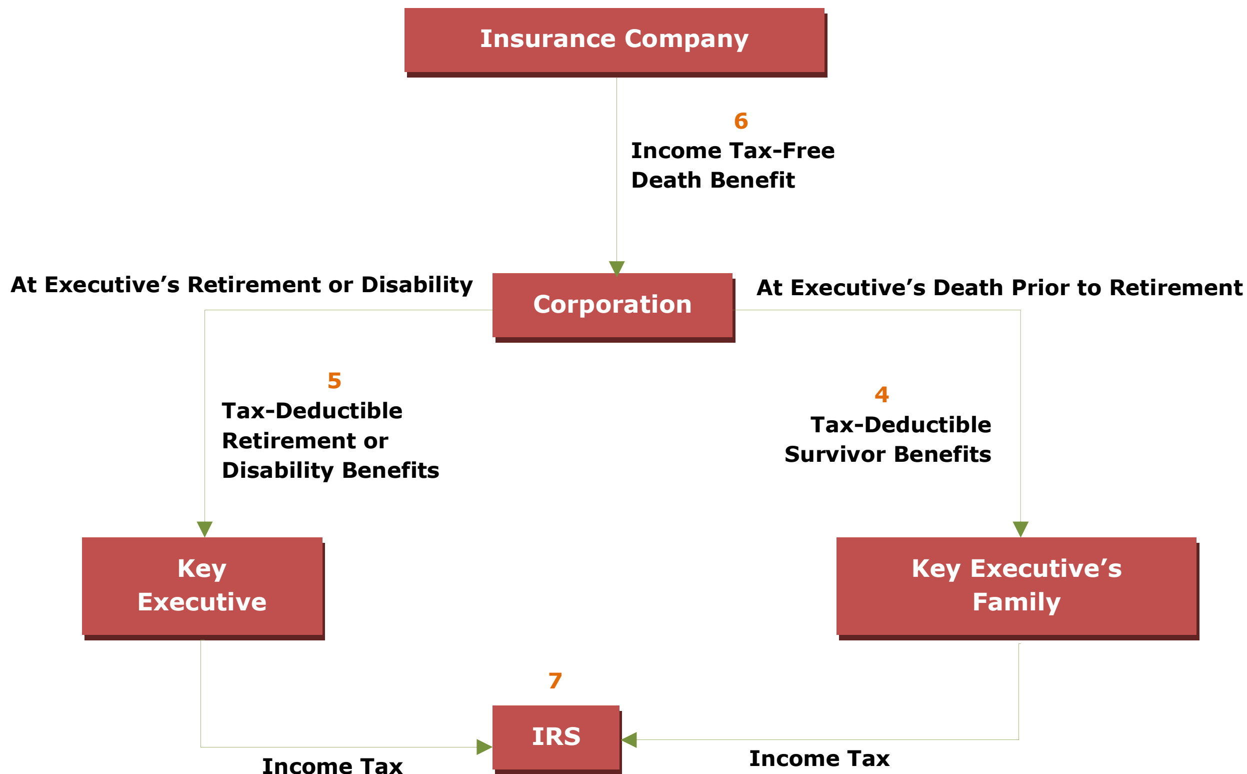
Deferred Compensation Plan in Action

Here's how promised benefits could be paid from a deferred compensation plan informally funded with life insurance...



4. If the key executive dies prior to retirement, the death benefit is received free of regular income tax by the corporation (assuming the requirements for employer-owned life insurance contracts are satisfied). The corporation can then use the income tax-free death benefit to pay the promised tax-deductible survivor benefits to the key executive's family.
5. If the key executive becomes disabled prior to retirement or remains actively employed until retirement, the corporation pays the promised tax-deductible disability or retirement benefit from current cash flow, from loans or withdrawals from the policy's cash value, or from a combination of the two (withdrawals and loans will reduce the policy's death benefit and cash value available for use).
6. By maintaining the policy until the key executive's death, the corporation ultimately receives the income tax-free death benefit to recover its costs.
7. Benefits received by the executive or the executive's family are taxable as received.

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