# Nonqualified Deferred Compensation and Split Dollar: The Dynamic Duo

Is your business thriving because of one or more critical top performers? Do you want a powerful fringe benefit to reward these critical employees? One effective benefit is the Nonqualified Deferred Compensation (NQDC) arrangement.

You and your employee would enter into a written agreement. You promise to pay your key employee a benefit at some later date, usually at retirement. The NQDC arrangement can also be designed to pay your employee's family a death benefit should he or she die before retirement. The promised benefit is taxed to your employee (or beneficiary) when it is actually received. At that time, you receive a corresponding deduction.

## The Dynamic Duo

In addition to the NQDC retirement benefit, you could also offer your top performer low-cost preretirement death benefit protection, under a Split Dollar arrangement. Both the NQDC benefit and the Split Dollar death benefit can be informally funded with the same whole life insurance policy. Keep in mind that the employee needs to be insurable in order for this arrangement to work.

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**The information provided is not written or intended as specific tax or legal advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.**

You and your employee would enter into two separate written agreements, each one spelling out the terms for each of the NQDC and the Split Dollar arrangements. You (the employer) own the policy and all the cash values under the Split Dollar arrangement. Your employee will name a beneficiary for the death proceeds in excess of cash value.

### Employee Tax Under Split Dollar Arrangement

While the Split Dollar arrangement is in effect, the employee must report as income each year the economic benefit of his or her current insurance protection, which is calculated by multiplying the employee's portion of the death benefit by the U.S. Government's 2001 Table or by the non-convertible term (NCT) rate, if lower, at the insured's attained age. The arrangement generally remains in effect until the employee retires (or otherwise terminates employment). If your employee dies before retirement, the death proceeds would generally be received income tax free by their family.

### What Happens at Retirement?

At retirement, the Split Dollar arrangement terminates and you (the employer) retain ownership and become the sole beneficiary of the policy. The NQDC agreement controls your remaining obligation to the employee. You have several options in making the promised NQDC benefit payments:

1 | You can use policy values to pay the promised benefit;

2 | You can pay the benefit using company revenues and maintain the policy to recover the costs of the arrangement from the death proceeds; or

3 | You can transfer ownership of the policy to the employee in full or partial satisfaction of the NQDC benefit.

### Things to Consider

At the employee's retirement, the employee will be taxed on the benefit transferred from your business under the NQDC arrangement. At that time, your business receives a deduction equal to the amount of compensation reportable by the employee. Also, as a form of golden handcuffs, the promised benefit to the employee can be made contingent upon the employee fulfilling certain requirements, such as remaining employed for at least ten years.

### Conclusion

The Dynamic Duo approach is flexible. For example, if you have a proven high performer you can offer this double benefit – an NQDC retirement benefit, as well as a Split Dollar preretirement death benefit. If you have a new high-potential employee that has not completely proven himself or herself as of yet, you can make a decision to immediately establish a Split Dollar arrangement providing that employee with a low-cost preretirement life insurance coverage option and postpone the decision for the NQDC portion.

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