STONEHEARTH
CAPITAL MANAGEMENT

EXECUTIVE BENEFITS

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THE LANDSCAPE OF VARIOUS EXECUTIVE BENEFITS PROGRAMS

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report will provide an overview of the landscape of various executive benefits programs that are used in the marketplace, provide information about the features and benefits of these plans, and the taxation of such plans.

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EXECUTIVE BENEFITS

Employee benefit plans are a key component of total compensation packages as companies of all types compete for the services of talented personnel. Aside from standard medical and dental coverage, the foundation of most employee benefit programs is a type of benefit plan that allows and encourages employees to save a portion of their earnings for retirement. These plans fall under what is commonly referred to as tax-qualified plans, such as 401(k)s, 403(b)s, SIMPLE IRAs, etc. These plans have the advantage of allowing pre-tax contributions and tax-deferred growth on the earnings within the account.

These qualified plans are a nice starting point for employee benefit programs and for most rank and file employees, these plans provide an adequate way to save for retirement or other future expenses. However, there are some tradeoffs with qualified plans that don't make them ideal when employers want to provide benefits to highly compensated executives and other key personnel.

These tradeoffs include rules related to plan eligibility requirements and limitations on maximum employee contributions. As a result of these rules, qualified plans generally don't provide executives with a mechanism to defer the same percentage of their overall income that non-executive employees can. Given these tradeoffs, many employers turn to nonqualified executive benefit strategies to supplement their qualified plans.

Many executive benefit plans fall under the category of non-qualified plans. Non-qualified plans derive their name from the fact that they are not subject to the same set of IRS rules that govern qualified plans.[1] For example, when offering a qualified plan such as a 401(k), an employer cannot discriminate and offer the plan to only certain individuals, such as executives. Furthermore, employees are limited to how much money they can contribute, regardless of how high their salary may be.

Conversely, non-qualified plans have a separate set of rules they must follow, but the primary advantage of these plans is that they don't have to follow the complex set of rules that govern qualified plans and they can be offered only to executives and highly compensated employees. As a result, these plans can be a very important part of an executive's overall financial plan and when properly leveraged, these plans can strongly contribute to an individual's ability to achieve their financial goals.

The goal of this paper is to provide an overview of the landscape of various executive benefits programs that are used in the marketplace and provide information about the features and benefits of these plans and the taxation of such plans.

TYPES OF EXECUTIVE PLANS

Generally speaking, executive benefit plans will fall into one of two main categories. The first category of executive benefit plans is non-equity based plans that provide a deferral of compensation whereby plans are designed to provide income to an executive at a future date. There are various types of plans within this category.

The other category of executive benefit plans can be described as equity-based benefit plans, where executives are compensated above and beyond their base salary with actual company stock, stock options, or some other financial benefit based on the company's stock price.

We will first cover the various types of non-equity based deferred compensation plans, followed by a discussion of equity-based benefit programs.

NON-EQUITY BASED EXECUTIVE PLANS:

Non-equity based executive benefit plans can be structured under a variety of different plan types, but will generally fall into one of the following categories:

- Non-qualified Deferred Compensation Plans
  - Traditional Deferred Compensation Plans
  - Supplemental Executive Retirement Plans
- Executive Bonus (Section 162) Arrangements
- Death Benefit Only Plans
- Split-Dollar Life Insurance Plans

NON-QUALIFIED DEFERRED COMPENSATION PLANS:

A non-qualified deferred compensation (NQDC) plan is an arrangement between an employer and employee that defers the receipt of currently earned compensation. If structured properly, an NQDC plan can allow for an employer to provide this benefit to a select group of executives or key employees. Highly compensated employees with access to these plans can opt to defer additional income over and above the deferral limits of qualified plans, such as 401(k) plans. NQDC plans are typically set up as either traditional deferred compensation plans or supplemental executive retirement plans (SERP).

TRADITIONAL DEFERRED COMPENSATION PLANS:

With traditional deferred compensation plans, executives can defer usually up to 80% or 90% of their base compensation and up to 100% of bonus compensation.[2] Executives can elect different deferral amounts each year, but are required to make their deferral election by the end of the year preceding the year the money will be earned.

Plans can be designed to only have deferred compensation paid to the executive at their retirement only, or plans may also offer a feature where executives can elect to have deferrals paid out to them at various times in the future to coincide with different economic needs. For example, an executive can make an election by the end of 2017 to defer 40% of their base compensation in 2018 and elect to have 10% of that deferred money paid to them when their child is attending college, and the remaining 30% paid to them at retirement. Each year, they can choose to defer different amounts and select the timing of when they'd like to receive those deferred payments.

TAXATION OF NQDC PLANS:

As mentioned earlier, non-qualified plans do not have to follow the same strict and complex rules of qualified plans, however the IRS does have a set of rules and guidelines that non-qualified plans, such as NQDC plans must follow. These rules are set forth under Section 409A of the Internal Revenue Code.[3] When an NQDC plan is properly structured under these rules, deferred earnings are not subject to income tax until they are actually received by the executive. This has the effect of allowing the executive to lower their taxable income currently by deferring compensation to a later date, at which time that income will be taxed when received.

To preserve the ability of executives to defer income tax on deferred compensation, the plan must be unfunded, meaning that any income deferred cannot be specifically set aside in an account with a third party and owned by the executive.[4] This is an important difference from qualified plans, such as 401(k) plans, which feature individual accounts held outside of the corporation in the name of each plan participant. With a qualified plan, each plan participant owns the account that their elective deferrals are deposited into. Conversely with an NQDC plan, any income deferrals by all plan participants are held as general assets of the employer. This also means that the deferred compensation is subject to the creditors of the corporation in the event of corporate insolvency. With unfunded plans, executives are not guaranteed to receive their benefits in the future.

With an unfunded plan, the company does not specifically set aside assets in individual separate accounts to pay plan benefits. Instead, the employer will either pay plan benefits as they become due from current cash flow, or earmark assets to pay plan benefits through a method called informal funding.

Informally funded plans are still considered unfunded and fall within Section 409A guidelines, since any assets that the company sets aside to pay plan benefits must be held as general assets of the corporation and subject to the claims of corporate creditors. For example, if a company offers a deferred compensation plan to 10 executives who all elect to defer compensation, the corporation will hold all deferred compensation together as a corporate-owned asset, not in separate accounts owned by each executive.

Unfunded or informally funded plans are common methods of structuring deferred compensation plans because they can provide the benefit of tax deferral while avoiding almost all of ERISA's requirements.[5] In order to achieve the dual goals of tax deferral and avoidance of ERISA, an NQDC plan must be both unfunded (including informally funded) and maintained for a select group of management or highly compensated employees. These types of NQDC plans are referred to commonly as "top-hat" plans.[6]

NQDC PLAN DESIGN FEATURES:

NQDC plans are often designed to assign growth on deferred income to provide for an investment element to the assets. Some plans may assign a pre-determined fixed rate of return credited to plan assets. For example, each year as executives defer income, the employer credits the deferrals with a rate or growth such as 5%. The total amount of deferrals, plus the growth, dictates the executive's plan balance to determine future plan benefits.

To make NQDC plans more robust and give them the look and feel of a qualified plan, some corporations design their plans to allow executives to allocate their deferred income across a lineup of investment options, such as mutual funds. Sometimes these funds mirror the investment options available in that company's 401(k) plan since there is familiarity with these options.

Note however, that the company does not have to actually invest the deferred income in the investments chosen by the executive. Instead, the investment experience of the chosen options is tracked as if the assets were invested in the funds and the result determines the executive's plan balance for future benefits. In this case, where no money is actually invested in the funds that the executives choose to determine their benefit, the executive's plan balances are said to be in bookkeeping accounts. In some cases, companies may decide to invest the deferred assets in investments of their own choosing to achieve growth similar to the growth of the executive's bookkeeping accounts.

As described above, when an executive elects to forego the receipt of currently earned compensation and defer it as part of an NQDC plan, the employer now holds those funds that have not been paid out. Executives must accept some risk when they defer income since the assets are now exposed to either corporate creditors, or even a change of heart on the part of the corporation to use those assets for something other than paying plan benefits.

The reality is that most corporations fully intend to pay out plan benefits to executives in the future and employers often design plans to provide some measure of security around the deferred assets while staying within the rules of Section 409A.[7] To accomplish this, some companies deposit the retained deferred income into certain investment products and use various mechanisms to earmark these assets to better ensure that assets are available to pay plan benefits in the future when they become due. Recall, however, that in order to maintain tax deferral of these funds for executives, the deferred income cannot be set aside in individual accounts owned by the executive, the assets must still remain as a corporate-owned asset.

PLANNING POINT: *NQDC Plans are primarily suitable for employees of C corporations. In S corporations or unincorporated entities (partnerships or proprietorships) that feature pass-through taxation, business owners generally can't defer taxes on their business income.*

CORPORATE-OWNED LIFE INSURANCE (COLI):

One method elected by companies, is to use corporate-owned life insurance policies to informally fund NQDC plans. In these cases, companies use the deferred compensation assets to deposit into insurance policies with the goal of investing the assets for growth. The company is both the owner and beneficiary of the policy. Companies can then elect to pay future plan benefits out of general cash flow or from the cash value of the insurance policies. With this method, each executive that defers income can be covered by a life insurance policy that is owned by the corporation. The executive is the insured, but does not control the policy or have the ability to access the cash value.

Employers favor the use of life insurance to informally fund NQDC plans for two primary reasons:

1. The growth of the cash value inside the life insurance policies is tax-deferred to the corporation.
2. In the event of a pre-mature death of one the corporation's executives, the employer receives the death benefit, tax-free, and can use this to pay deferred compensation benefits to the executive's estate, and to help offset employer-borne costs associated with the plan.

RABBI TRUSTS

Companies may also elect to use what is known as a rabbi trust in order to satisfy its obligation to provide executives with benefits under an NQDC plan.[8] An employer would establish a rabbi trust to hold assets earmarked for paying future plan benefits to executives. The goal is to provide some assurance to executives that assets will be available for the payment of future benefits due under the terms of the plan. The benefit to executives is that with the assets in this type of trust, the assets are held separately from the company's other assets and are less likely to be used for other corporate expenditures. However it is sometimes said that the rabbi trust places only a "partial wall" around the assets since the assets are still subject to corporate creditors in the event of bankruptcy or insolvency.

PLANNING POINT: *A rabbi trust can be established as revocable or irrevocable. If the trust is irrevocable, the employer forfeits the right to use NQDC plan assets until all plan benefits have been paid. The assets can only be used to satisfy the company's obligation to pay plan benefits, but if bankruptcy or insolvency occurs, the assets become accessible to the company's general creditors.*[9]

PLANNING POINT: *Although everyone's financial situation should be independently evaluated, it is generally recommended for executives to take advantage of deferred compensation plans when they are available to them. The advantages are the ability to lower current taxable income and elect to receive the income at a future date, such as retirement. However, it is also advised that executives contribute the maximum amount to available qualified plans before electing deferrals to NQDC plans. This is because qualified plans offer protection of the assets under ERISA rules, while deferred income under NQDC plans is not guaranteed. Individuals with access to NQDC plans should discuss the pros and cons of these plans with a financial advisor to determine the appropriate amount of compensation to defer.*

SUPPLEMENTAL EXECUTIVE RETIREMENT PLANS

A Supplemental Executive Retirement Plan (SERP) is another type of NQDC plan used by employers to benefit executives. As discussed above, the traditional deferred compensation plan allows the executive to defer a portion of their own salary and bonus. With a SERP, this arrangement involves funding future benefits to the executive strictly with employer-provided benefit payments.

A typical SERP arrangement involves an agreement between the employer and employee where the employer agrees to pay additional compensation payments to the executive at a later date – usually retirement. For example, a SERP agreement could be designed to have the employer pay ten annual installments of $100,000 to the executive upon retirement, with a retirement age defined in the plan agreement. With this arrangement, the executive does not need to defer any of their currently earned compensation. Instead they are promised an additional financial benefit from the corporation's assets at a future date. When properly structured, executives are not taxed on benefits under a SERP arrangement until they are paid out to the executive.

Similar to traditional deferred compensation plans described above, SERPs are a promise to pay the executive a future payment, but assets are not specifically set aside in an account owned by the executive. The corporation can elect to use the same informal funding vehicles as described above (COLI, rabbi trusts), but assets earmarked for the payment of future benefits under a SERP arrangement remain general assets of the corporation subject to corporate creditors.

INSURANCE BASED EXECUTIVE BENEFIT PROGRAMS

Other forms of executive benefit programs that fall under the non-equity based plan types are:

- Executive Bonus (Section 162) Arrangements
- Death Benefit Only Plans
- Split-Dollar Life Insurance Plans

The features and benefits of these plans are described below.

EXECUTIVE BONUS (SECTION 162) PLANS

Executive Bonus Plans, also sometimes referred to as Section 162 Bonus Plans due to the section of the Internal Revenue Code that provides some guidance for the tax deductibility of these plans, are a way for employers to provide additional benefits to executives and key employees.

It's common for companies to pay additional compensation to executives in the form of incentive-based bonuses typically paid out as cash. However, the term Executive Bonus Plan or Section 162 Bonus Plan usually refer to an arrangement where a bonus paid to an executive is used to purchase a life insurance policy. Usually a life insurance policy that has a cash value component is used and the executive is the owner of the policy and designates the beneficiary.

An advantage to using life insurance in this type of arrangement is that any cash value accumulation will grow tax-deferred and the executive can access the cash value at a later date to supplement retirement income or other financial need. Additionally, since the executive designates their own beneficiary of the policy, usually family members or a trust, their heirs will receive the death benefit proceeds from the policy income tax free.

Executive Bonus Plans typically don't fall under the deferred compensation plan category since bonuses paid to the executive in the form of the annual premium to the life insurance policy are included in the taxable income of the executive in the year they are paid. The expectation with this type of plan is that the company will pay a bonus each year for several years with that payment being deposited into the life insurance policy in the form of an annual premium.

An advantage that Executive Bonus Plans have that differs from NQDC plans is that by owning the life insurance policy and having access to the cash value, the asset is personally owned and not exposed to creditors of the executive's employer. However, a drawback with these plans is the bonus paid is added to taxable compensation for the year and does not provide for a way to defer the bonus payment and defer taxation.

DEATH BENEFIT ONLY (DBO) PLANS

Another type of insurance-based executive benefit plan is the Death Benefit Only Plan. The goal of this arrangement is to provide survivor benefits to the heirs of an executive or key employee who dies prior to retirement. Typically, the company agrees through a written agreement to pay an amount equal to the executive's salary for a term of years after the executive's death. The survivors pay taxes on any benefits received. These plans are structured to have the company be the owner and beneficiary of the life insurance policy with the executive being the insured. The company controls the policy and upon the death of the executive, the company receives the death benefit and is obligated to pay the survivors in accordance with the terms of the DBO Agreement.

SPLIT DOLLAR PLANS

Split dollar plans are a type of executive benefit plan funded by the use of life insurance. Just like other plans described above, companies can choose which executives and key employees it wants to provide this benefit to. Split dollar plans derive their name from the fact that with this type of arrangement, a life insurance policy's premium, cash values, and death benefit are split between two parties.

In general terms, split dollar plans feature the payment of premiums by an employer via a loan to the executive (or in some cases, the executive's trust), who owns the policy. The executive, or their trust, reports an amount less than the full premium payment as income each year. The ultimate goal of these plans is to provide cash value (which grows tax-deferred within the life insurance policy) to the executive to supplement retirement income needs, and to provide additional death benefit to the executive.

In 2003, the IRS issued final split dollar regulations, which significantly changed the landscape of these arrangements in many important ways.[10] The final regulations added complexity to the design and administration of split dollar plans and therefore, they are not as widely used today as they used to be. However, many split dollar plans remain in existence today, and if you have an existing split dollar plan, we can review the arrangement for you and provide guidance regarding your available options.

EQUITY BASED EXECUTIVE BENEFIT PROGRAMS

Up to this point, we have focused on executive benefit programs that seek to provide financial benefit to executives, but are not tied in any way to the value of the company's stock or do not provide company stock as the basis of the benefit. Many companies have also developed equity-based benefit programs for senior executives to provide stock ownership and an increased incentive to executives tied to the increase in the share price of the company's stock. The following section of this paper will outline various types of stock-based executive benefit programs that can provide shares of company stock to executives or additional cash compensation tied to the value of the company's stock.

The types of equity-based compensation strategies that we will cover here include:

- Restricted Stock and Restricted Stock Unit (RSU) Plans
- Non-qualified Stock Option Plans
- Incentive Stock Option Plans

RESTRICTED STOCK AND RETSTRICTED STOCK UNITS (RSUs)

Restricted stock and RSUs refer to a type of employee benefit that grants company shares to employees. The granted shares are "restricted" because they are subject to a vesting schedule, usually based on a term of continued employment or specific performance goals. An employee cannot sell or transfer the shares until the vesting requirements have been met.

Some companies issue restricted stock as part of an executive compensation package that includes stock options (discussed later). Although restricted stock plans and stock option plans are based on company stock, there are some important differences between the two types of benefits.

With restricted stock plans, the company grants shares of stock to the executive on what is referred to as the grant date. The plan will designate a vesting date in the future when the restriction is lifted and the employee is said to be vested in the stock. Since shares are granted directly to the employee in a restricted stock plan, during the restricted period the employee is entitled to receive any dividends that the company pays, and grant-holders have voting rights.

Once vested, the restriction is lifted and the employee owns the share outright. They can choose to hold the share or sell it at that time. Upon the vesting date, when the restriction is lifted, the employee recognizes the value of the share on the vesting date as compensation and pays ordinary income tax.[11]

Let's illustrate how restricted stock works through the following example.

Example: ABC Company issues 1,000 shares of restricted stock to an executive when the market price of the stock is $20 per share. As long as the executive remains employed with the company for three years, they become vested in all 1,000 shares, and the restriction is lifted three years after the grant date. Three years later on the vesting date, the market price of the stock is $25 per share. The executive will recognize $25,000 (1,000 shares x $25/share) of additional compensation in the year they vested in the shares. The vesting date begins the holding period of the shares for the executive and any future gain (or loss) on the shares above (or below) $25/share will be taxed at short or long-term capital gains rates depending on their holding period.

Restricted Stock Units (RSUs) are a similar type of benefit, but have some important differences. With an RSU, no stock is actually issued to the employee upon the grant date. Instead, RSUs represent an unfunded promise to issue a specific number of shares (or a cash payment) to the employee in the future, once vesting conditions have been met.[12] With RSUs, the employer has a bookkeeping entry of the amount of units that have been granted to each employee, but shares are not actually issued to employees until vesting. Additionally, since the employee is not issued shares upon grant of an RSU, they do not hold voting rights and cannot receive dividends while waiting for the RSUs to vest.

The taxation of RSUs is similar to restricted stock in that the executive recognizes compensation upon the vesting of RSUs to the extent of the market price of each share and the amount of RSUs granted. Using the same example above, but with the assumption of the use of RSUs, the executive would again recognize the same $25,000 of compensation upon vesting. With RSU plans, however, the company can decide whether it will issue actual shares to the executive upon vesting, or provide a cash payment in lieu of shares.

PLANNING POINT: *Restricted Stock and RSUs are effective benefits since they will always have value to employees, even if the market value of the company's stock falls after the shares have been granted. Using the example above, assume the same share price at grant of $20, however let's also assume that three years later upon vesting, the share price has dropped to $15 per share. Given a grant of 1,000 shares (or RSUs), the employee still realizes a value of $15,000 upon vesting. This fact is not true of employee stock options (discussed below). If the value of the company's shares falls after the grant date, the options may have no value to the employee upon vesting.*

EMPLOYEE STOCK OPTIONS

A stock option is an employee benefit that gives an employee the right to purchase a specified number of shares of the company's stock at a fixed price during a defined timeframe.[13] Under a stock option plan, when an employee wants to purchase a share, this is called the exercise and the purchase price is called the exercise price. In almost all cases, the exercise price is equal to the market value of the company's stock on the date the option was granted. Most stock option plans also include a vesting period to dictate an amount of time before an employee is permitted to exercise a stock option.

Stock options have become an increasingly popular part of executive compensation packages as companies look to provide excess benefits to key employees.[14] There are two different types of stock options used in employee benefit plans: nonqualified stock options (NSOs) and incentive stock options (ISOs). The primary difference between these options is the manner in which they are taxed, which is discussed below.

NON-QUALIFIED STOCK OPTIONS (NSOs)

Non-qualified stock options are the most common form of employee stock options and they can be granted to officers, directors, contractors, and consultants, as well as employees. The term "non-qualified" comes from the fact that NSOs do not qualify for favorable tax treatment under IRS rules. The taxation of NSOs is fairly straightforward and the taxable event is triggered when an employee exercises the option.

In the example, the company adds $1,000 of compensation income to this employee's W-2 for the calendar year of exercise. As with regular wages, the company will withhold income tax, Social Security, and Medicare taxes from the compensation income represented by the spread upon exercise of NSOs. The spread is always the difference between the exercise price and the fair market value on the date of exercise.

Example of NSO Taxation: A company grants 500 NSOs to an employee with a grant price of $20 per share (the fair market value of the shares at the time of grant). Upon vesting, the share price has increased to $30 per share and the employee decides to exercise 100 options. There is a $10 spread (difference in the value of the share at exercise and the exercise price: $30 - $20), therefore the employee has $10 per share of ordinary income, or $1,000.

The employee's holding period for the stock begins on the date of exercise, and their tax basis for the shares is the fair market value of the shares on the date of exercise. Any future gain above that price that is realized upon future sale of the stock will be taxed according to normal holding period rules of short or long-term capital gain. The tax basis of a share acquired via an NSO is constructed of the exercise price, which is paid by the employee to acquire the share, plus the spread, which is the amount above the exercise price that is recognized as compensation.

For example, using the same employee from the scenario above, the employee's tax basis after exercise is $30. If they hold the shares for more than one year after exercise and sells the shares when they are valued at $35/share, they will have $5/share of long term capital gain.

INCENTIVE STOCK OPTIONS (ISOs)

Incentive Stock Options are a different type of employee stock option typically offered to executives and key employees.[15] ISOs qualify for favorable tax treatment if certain requirements are met. As we discussed above with NSOs, the spread between the exercise price and the fair market value on the date of exercise is taxed to the employee as ordinary income. Conversely, with ISOs, if the employee holds the acquired shares for at least one year after exercise (and two years after the grant date), any gain over the exercise price incurs long-term capital gain treatment. Also, when these conditions are met, the gain is not subject to Social Security or Medicare taxes.

> Example of ISO Taxation: A company issues 1,000 incentive stock options to an executive on June 1, 2015. At the time of grant, the market value of the stock is $40/share, which is the exercise price. The vesting schedule is designed to have 25% of the options vest each year. One year later, on June 1, 2016, the executive decides to exercise the first 250 options that became vested. The share price on the date of exercise is $45/share. The executive must pay $10,000 (250 x $40) to exercise the shares. On August 1, 2017, the executive sells all 250 shares for $50/share.

In addition to the example above, since the executive held the shares for at least two years after grant and more than one year after exercise, the entire gain above the exercise price ($50 - $40) is taxed at the long-term capital gains rate. In this case, the share price of $45 on the date of exercise is disregarded, and does not factor into the calculation of gain.[16]

The taxation of Incentive Stock Options is very complex and careful planning is critical for anyone holding ISOs. For example, the exercise of ISOs often exposes the taxpayer to the Alternative Minimum Tax (AMT). Consideration should be given to determining the amount of ISOs that can be exercised in a given year without triggering AMT. It is also important to note that while exercising ISOs does not trigger a reportable gain for regular tax in the year of exercise, the spread between the exercise price and the share price on the date of exercise is reportable income in the year of exercise for purposes of calculating whether the AMT applies.

PLANNING CONSIDERATIONS WITH RESTRICTED STOCK, RSUs, & EMPLOYEE STOCK OPTIONS

Equity-based compensation plans can offer a tremendous benefit to executives. When leveraged properly and with careful consideration to tax treatment, the value derived from these plans can significantly contribute to achieving financial goals.

When employers offer equity-based compensation plans to executives and key employees, it is common that lots of restricted stock, RSUs, and both types of stock options can be granted to employees every year. Therefore, attention must be paid to various vesting schedules and expiration dates of stock options to ensure that options don't expire before exercising them. Additionally, the continual vesting of restricted stock and exercising of stock options can lead to an over concentration of ownership of one company's stock. Individuals should develop a plan around understanding the percentage of their overall portfolio that is comprised of company stock and consider when it is time to diversify out of that stock to reduce concentration risk in their portfolio.

Stock options also provide flexibility with the timing of exercising, which can help to manage the timing of when taxable events are triggered. With proper planning, a pre-determined schedule of exercise timing can be considered to avoid triggering additional tax in a year when other additional compensation, such as a large bonus or the vesting of restricted stock, is realized. Also, not paying attention to expiration dates of options, and waiting to exercise all options in the year they expire, may take away some advantageous tax planning that may have been available if options were exercised over multiple years.

SUMMARY

We hope that you found this whitepaper on Executive Benefits to be helpful and informative. At Stonehearth Capital Management, we have experience with reviewing and understanding plan documents associated with various executive benefit plans, NQDC plans, and split dollar arrangements. We also have tools to help you manage various equity-based compensation plans and can help formulate plans to maximize the benefits derived from restricted stock, RSUs, and stock options.

Please remember that nothing referenced in this paper should be construed as legal or accounting advice. Legal or accounting advice should only come from a qualified attorney or accountant.

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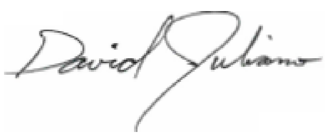
Sincerely,



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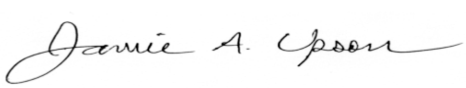

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[1] Qualified plans must comply with rules set forth in the Employee Retirement Income Security Act (ERISA) of 1974. This complex set of rules governs participation, vesting, funding, reporting, disclosure, administration, and fiduciary activities. While ERISA governs most qualified retirement plans, nonqualified plans can be designed to avoid almost all of ERISA's requirements.
[2] The rules for NQDC plans permit the deferral of up to 100% of base compensation, but typically individual plan documents dictate maximum deferral amount less than 100% of base compensation.
[3] If an NQDC plan fails to follow the rules of Section 409A, plan benefits, including all benefits deferred in prior years, may become immediately taxable to executives, and possibly subject to penalties and interest charges. It is important for employers to ensure that an NQDC plan follows the rules of Section 409A when establishing the plan.
[4] An NQDC plan can be a funded plan, where deferred compensation is irrevocably and unconditionally set aside with a third party for the payment of plan benefits in the future, and the plan assets are beyond the reach of the corporation and its creditors. This guarantees the receipt of plan benefits in the future. Funded plans are rarely used, however, because they do not feature the same tax deferral as unfunded plans.
[5] For an unfunded plan, almost all that ERISA requires is that you send a simple statement to the Department of Labor informing them of the establishment of the plan, and the number of participants.
[6] The IRS has not formally defined a "select group of management or highly compensated employees", however it has become accepted for this group to include a small percentage of the employees in a

corporation who are key management, senior executives, or who earn a salary substantially higher than other employees.

[7] Recently released proposed tax reform under the Tax Cuts and Jobs Act contains provisions that could significantly affect deferred compensation plans. Proposed legislation includes the elimination of Section 409A, which governs deferred compensation plans and other executive benefits. Stay tuned for our updates to the information in this paper pending the passage of any new legislation under this proposed Bill.

[8] These trusts are called rabbi trusts because a rabbi was the beneficiary of the first such trust to receive a favorable ruling from the IRS.

[9] Note that executives who have deferred income under an NQDC plan are unsecured general creditors of the corporation and may still receive benefits in the event of bankruptcy or insolvency, but they must "stand in line" behind the secured creditors of the corporation and their benefits are not guaranteed.

[10] The final regulations issued by the IRS apply to split dollar arrangements entered into after September 17, 2003. Arrangements entered into prior to this date are not governed by the final regulations unless modified after September 17, 2003.

[11] With a restricted stock grant (but not with an RSU), it is possible to shift the timing of taxation from the vesting date to the grant date, under the provisions of a Section 83(b) election. The details of taxation under an 83(b) election are beyond the scope of this paper. If you have restricted stock grants, we can help you determine if using this election makes sense in your situation.

[12] Your source for content and education on stock options, ESPPS, restricted stock, SARs, and other stock compensation - myStockOptions.com. (n.d.). Retrieved November 28, 2017, from http://www.mystockoptions.com/

[13] Your source for content and education on stock options, ESPPS, restricted stock, SARs, and other stock compensation - myStockOptions.com. (n.d.). Retrieved November 28, 2017, from http://www.mystockoptions.com/

[14] Recently released proposed tax reform under the Tax Cuts and Jobs Act contains provisions that could impact employee stock option plans. The initial version of the proposed Bill contains language that would move the taxation of stock options to the vesting date.

[15] Incentive Stock Options can only be offered to employees, not contractors or consultants.

[16] If shares acquired through ISOs are sold within one year of exercise, it is considered a disqualifying disposition, and the spread from the exercise price up to the price of the shares when sold is taxed as ordinary income tax rates.