SALES IDEA | Principal® Select Reward Plan

Building Loyalty with an Executive Rewards Plan

Profile

Business owners with one or more executives critical to the success of the business.

Challenge

How can these owners tie the executive to the business? What kind of benefit is meaningful and encourages the employee to stay with the business for some period of time, yet offers something of value to the executive *now*?

Solution

The Principal® Select Reward Plan from the Principal Financial Group® avoids the complexities of complying with Internal Revenue Code Section 409A and still provides a self-completing benefit that ties select executives to the business.

The employer purchases a permanent life insurance policy on the key executive using after-tax corporate dollars. The employer endorses a portion of the death benefit to the executive's family and retains all other rights of policy ownership. In a separate agreement, the employer agrees to pay a lump sum bonus to the executive if he or she stays employed during the defined timeframe.

Case study

The owner of a business has a nephew (age 30) and a son (early 20s) both working in the business. The owner wants the business to eventually go to his son, but believes strongly that the nephew is a key player in the business. He wants to be sure to retain the nephew for the next 15 years. His offer to the nephew is this: "If you stay until age 45, the business will pay you $400,000. If you leave before then, you get nothing." During the service period (15 years), the business provides a $500,000 death benefit to ensure the nephew's beneficiaries receive a benefit in case of his death.

Benefits and considerations

For the business:

- A method for influencing key employee company loyalty during a pre-determined service period (generally 12-15 years). One financing vehicle for funding multiple benefits.
- In the event of premature death, a tax-free death benefit may be received to recover the cost of the life insurance premiums paid.
- Premiums are paid with corporate, after-tax dollars. Each premium payment reduces annual cash flow.
- Bonus must be paid in a lump sum within 2½ months of the end of the tax year in which the executive meets the service requirement to avoid being considered a deferred compensation plan and subject to IRC Section 409A requirements.
- Business gets a tax deduction when the lump sum bonus is paid out.

For the executive:

- Income tax must be paid on the economic benefit costs during the service period — a significantly lower cost than paying the entire premium on a term insurance policy.
- Executive must provide evidence of insurability to qualify for the life insurance policy.
- Executive pays income tax on the entire bonus in the year it is received. There is no option to receive annual payments, or to defer the bonus. Policy values may be used to pay the income taxes due on the bonus, in the year in which the bonus is paid.
- Policy cash values may be accessed for personal financial needs once policy ownership is transferred.

FOR MORE INFORMATION

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