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BUSINESS BUILDER: EMPLOYEE BENEFITS

Michael Bischoff & Ryan Shannon, August 2007

You can keep key employees with smart rewards

BUSINESS OWNERS may know why their company is a good place to work, but it is imperative for employees to agree.

There are various plans for fostering a rewarding work environment. The overall strategy is to make key employees more involved in the success of the business. Here's a rundown of some top options:

- ***Deferred compensation.*** A nonqualified deferred compensation plan is an arrangement between an employer and an employee to defer the receipt of currently earned compensation.

The Internal Revenue Service does not allow these plans to have the same tax-favored benefits of qualified retirement plans because they do not have to comply with the participation, vesting, funding, distribution and reporting requirements that apply to qualified plans.

Deferred compensation plans can be funded, where the monies are held in trust, or unfunded, which are commonly referred to as "top-hat plans." Deferred compensation plans work well as a tool to keep key employees by providing incentives for results that benefit both the employee and the company.

- ***Employee Stock Ownership Plan.*** An ESOP is a type of deferred compensation plan that you can use to reward key employees and plan for the transition of the business. An ESOP can be structured in many ways but should be customized to fit the needs of each business.

Like a nonqualified deferred compensation plan, an ESOP plan is paid for today by the employees' earnings but kept aside for the future through a vesting schedule. This is an effective employee retention strategy and gives them an equity interest in the success of the company.

ESOPs are also an effective succession-planning tool as they can be scheduled to fully or partially "buy out" the owner within a determined time frame. The business owner can decide on the successor and train that person or people while they are earning the future buyout. A business will, coupled with a buy-sell agreement, can also be written into the plan.

Such succession-planning tools are essential to the survival of the business should there be an untimely death or disability of the owner and therefore protecting their family, the employees, and the business.

- **Retirement plan supplements.** A 401(k) wraparound plan, also known as an executive 401(k) plan, is a nonqualified plan that supplements or "wraps around" the already existing 401(k) plan that you offer to your employees. The purpose of this plan is to provide a vehicle for the employee to contribute more than \$15,500, the maximum allowed in 2007.

Also, the business can have separate rules to match the employer contributions outside of the rules of the 401(k) plan that is above and beyond the standard match. The wraparound plan usually works like the existing plan with the same investment options.

This plan is effective in situations where the 401(k) plan has annual top-heavy testing limits and highly compensated employees cannot defer sufficient amounts into the plan.

- **Life insurance** to fund key-employee benefits. In a split dollar life insurance arrangement, the employer pays the portion of the premium that contributes to the cash value of the policy, and the employee pays the insurance portion.

This is done primarily so the company can provide a cash bonus and receive a return of premiums when benefits are payable while the employee gets tax deferral on the earnings.

Split dollar life insurance can be an inexpensive and effective tool for attracting and retaining certain key employees. IRS approval is not required for a split dollar plan, making it relatively easy to establish.

- **An executive bonus** (Section 162) plan involves an addition to regular salary or compensation with a fully funded cash value life insurance contract. The company pays the annual premium of the policy, which is claimed by the employee as taxable wages. Therefore, the employer will take an income tax deduction under Internal Revenue Code Section 162 for the amount of the bonus, which is usually equal to the premium.

More options

Employers are not limited to additional compensation when rewarding key employees. There are other options available. One option is the below-market executive loan, which is a loan that a privately held company makes available to its executives as a supplement to their regular compensation. Publicly held companies are prohibited from making loans to executives under the Sarbanes-Oxley Act of 2002. Typically, such loans are interest free or made at a favorable interest rate.

Another option would be to offer generous vacation schedules or annual sabbaticals, which can recharge employees and effectively make them more productive.

For a truly rewarding employee experience, make sure to cultivate a constructive work environment by utilizing key employee talent, fostering creative thought and providing quality managerial support.

Once you have established your plan, make it a point to review it on a regular basis to ensure it meets the needs of the business, the owner and the key employees. Don't let key employees get away because you made promises and didn't follow through.

Think seriously about what you want to accomplish, and then seek help from professionals who are knowledgeable about all the options. A motivated key employee can take your business to the next level.