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NQDC Financing Options: Using Life Insurance and Annuities

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If NQDC informally funded with:	Corporate Owned Life Insurance (COLI)	Split-Dollar Life Insurance* (Example: Employer owns policy, pays all or part of annual premium, and is entitled to receive -- upon death or surrender -- amount equal to policy's cash surrender value)	Corporate Owned Annuities
Consequences of dollars contributed -- employer	<ul style="list-style-type: none"> • Employer contributions consist of premium payments • No deduction allowed • NQDC accounts maintained on paper only 	<ul style="list-style-type: none"> • Employer contributions consist of premium payments • No deduction allowed • NQDC accounts maintained on paper only 	<ul style="list-style-type: none"> • Employer contributions consist of premium payments • No deduction allowed • NQDC accounts maintained on paper only
Consequences of dollars contributed -- employees	<ul style="list-style-type: none"> • No taxable income 	<ul style="list-style-type: none"> • Employee taxed annually on value of policy death benefit payable to employee's beneficiary, less employee's contribution 	<ul style="list-style-type: none"> • No taxable income
Tax consequences during accumulation period	<ul style="list-style-type: none"> • Generally, cash value builds tax deferred • C Corporations may be subject to alternative minimum tax (AMT), in which case cash value build-up may be taxed 	<ul style="list-style-type: none"> • Generally, cash value builds tax deferred • C Corporations may be subject to alternative minimum tax (AMT), in which case cash value build-up may be taxed 	<ul style="list-style-type: none"> • An annuity contract held by a corporation, partnership, or other "non-natural person" generally will not qualify as an annuity for federal income tax purposes • All income on the contract is taxable to employer
Access to assets during accumulation period	<ul style="list-style-type: none"> • Employer can withdraw cash value • Employer can borrow against policy (generally no deduction allowed for interest on loans totaling more than \$50,000 per insured) • Policy may be subject to claims of creditors 	<ul style="list-style-type: none"> • Employer can withdraw cash value • Employer can borrow against policy (generally no deduction allowed for interest on loans totaling more than \$50,000 per insured) • Policy may be subject to claims of creditors 	<ul style="list-style-type: none"> • Access depends upon terms of annuity contract • Policy may be subject to claims of creditors
Can employee direct investment of assets during accumulation period?	<ul style="list-style-type: none"> • "Earnings" on paper account could be based on employee-directed investment of phantom dollars 	<ul style="list-style-type: none"> • "Earnings" on paper account could be based on employee-directed investment of phantom dollars 	<ul style="list-style-type: none"> • "Earnings" on paper account could be based on employee-directed investment of phantom dollars

<p>How are distributions made from nonqualified deferred compensation plan?</p>	<ul style="list-style-type: none"> • Payment of distribution will generally be made from employer cash flow and general assets • Employer may borrow against policies or withdraw cash value to meet obligations 	<ul style="list-style-type: none"> • Payment of distribution will generally be made from employer cash flow and general assets • Employer may borrow against policies or withdraw cash value to meet obligations 	<ul style="list-style-type: none"> • Cash flow from annuity may pay for distribution, or employer may access cash value
<p>Tax considerations upon distribution -- employer</p>	<ul style="list-style-type: none"> • Employer may deduct full amount of NQDC plan benefit payments 	<ul style="list-style-type: none"> • Employer may deduct full amount of NQDC plan benefit payments 	<ul style="list-style-type: none"> • Employer may deduct full amount of NQDC plan benefit payments
<p>Tax considerations upon distribution -- employee</p>	<ul style="list-style-type: none"> • Amount received is taxable income to employee 	<ul style="list-style-type: none"> • Amount received is taxable income to employee 	<ul style="list-style-type: none"> • Amount received is taxable income to employee
<p>Upon death of employee**</p>	<ul style="list-style-type: none"> • Policy death benefit paid to employer • Policy death benefit generally not taxable (may be included in C Corp's alternative minimum tax (AMT)) • Any unpaid NQDC plan benefits paid to employee's beneficiary (taxable income to beneficiary) 	<ul style="list-style-type: none"> • Amount equal to cash-surrender value of policy paid to employer, with remaining death benefit paid tax free to employee's beneficiary • Any unpaid NQDC plan benefits paid to employee's beneficiary (taxable income to beneficiary) 	<ul style="list-style-type: none"> • Any unpaid NQDC plan benefits paid to employee's beneficiary (taxable income to beneficiary)

***Caution:** In certain cases, split dollar life insurance may be considered nonqualified deferred compensation subject to the special tax rules contained in IRC Section 409A.

****Caution:** The Pension Protection Act of 2006 limits the amount an employer can receive as a tax-free death benefit from a COLI contract in certain circumstances.

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