Summary | Principal® Deferred Compensation – Select Reward

Giving your key employees a big reason to stay

Benefits for them – advantages for you

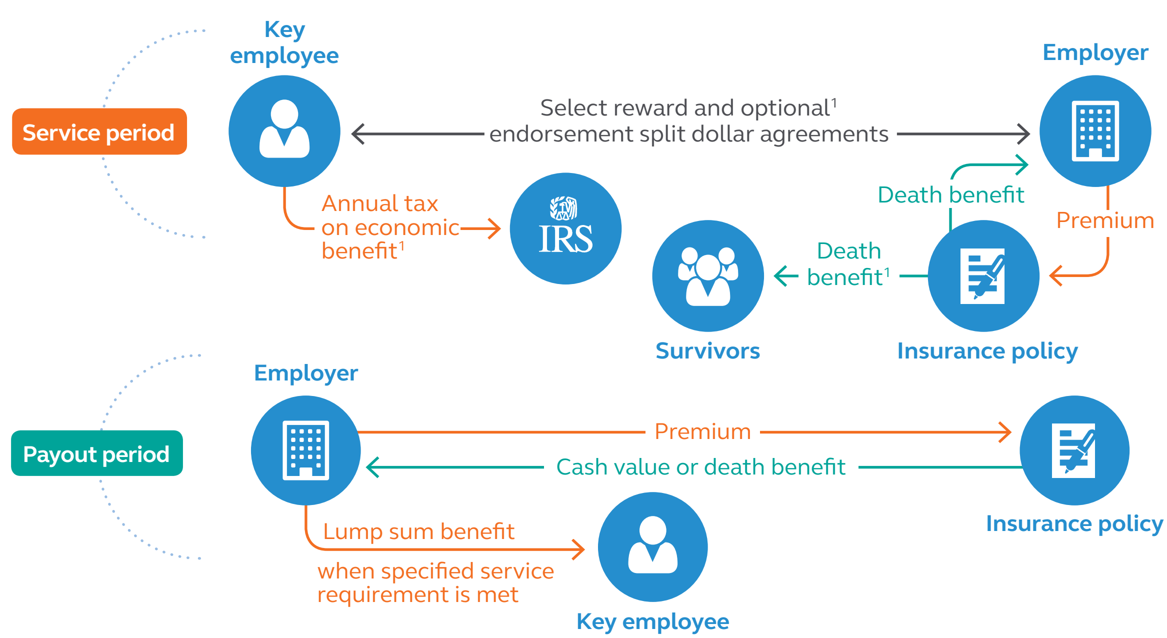
Your key employees help lead your company and keep it on the right path. So once you find the right top talent, keeping them is a priority. And it's equally important for key employees to work for a company that values their hard work – and offers them an incentive to stay.

This deferred comp plan could be an attractive solution for you and your key employees. It provides a lump-sum benefit to them at the end of a pre-determined service period, which encourages them to stay with you for the long term, instead of exploring opportunities with your competition.

Here's how it works

A deferred comp agreement is established with select key employees. You and each key employee enter into an agreement that promises a lump sum benefit if the employee satisfies a service requirement. The company then purchases and pays the premium on a life insurance policy that builds cash value. If desired, an endorsement split dollar agreement can be set up so that part of the policy's death benefit goes to the survivors if the key employee should die during the service period.

When the service requirement has been met, the lump-sum bonus will be paid to the key employee. You choose how the bonus will be paid. You may use current cash flow or a withdrawal of cash value from the life insurance policy to meet this bonus requirement. As an alternative, ownership of the policy can be transferred to the key employee.



[1] These items only apply if the optional endorsement split dollar agreement is used.

What you need to know

There are many advantages to this plan, just as there are some things to consider.

For you

Encourage loyalty – You provide incentive for the key employee to remain loyal to your company for a pre-determined service period.

Receive a tax deduction – In the year the bonus is paid or the life policy is transferred to the key employee, your company receives a tax deduction for the entire bonus. Any gain in the policy at this time of transfer is taxable to you.

Reduce cash flow – Premiums are paid with company after-tax dollars, so each premium payment reduces your annual cash flow.

Recover the premium cost – If the key employee dies before the end of the service period, the life insurance policy's tax-free death benefit[2] may be used to recover the cost of the premiums you paid.

For your key employee

Pay minimal cost – The key employee will pay tax on the value of the life insurance death benefit that's endorsed to them during the service period. This cost is much less than if the key employee was to personally purchase that amount of life insurance.

Help with taxes – This plan design does not allow the option to defer the lump sum bonus, nor does it offer another payment choice. In the year the bonus is received, the key employee recognizes income in the amount of the lump sum bonus. However, the policy's cash value may be used to pay the income tax due.

Use for personal needs – If ownership of the life policy is transferred to the key employee, its cash value and death benefit may be used for personal financial needs.

Must qualify – The key employee must be healthy enough to qualify for the life insurance policy.

Take note: The bonus must be paid in a lump sum within 2½ months of the end of the tax year in which the key employee meets the service requirement to avoid being considered a deferred compensation plan that would be subject to IRC Section 409A requirements.

Encourage your key employees to stay with you for the long term, instead of exploring opportunities with your competition, by providing this deferred comp plan. It's a great way to offer them a valued benefit, while helping your business keep its top talent.

[2] If the requirements of IRC Section 101(j) are not met, then death proceeds from employer-owned life insurance contracts may be taxable as ordinary income in excess of the cost basis.

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BB9682-09 | 04/2019 | 812514-042019 | ©2019 Principal Financial Services, Inc.