Scott Jones, CFP®, CLU, ChFC

scott@sjonesfin.com

Scott Jones Financial
5950 Fairview Road, Suite 402
Charlotte, NC 28210
www.sjonesfin.com
(704) 817-7324

Contact Us For A Complimentary Meeting

Handcuffing Key Employees NQDC Plans

Business Stock photos by Vecteezy

Keeping key employees committed to your business is an essential strategy for building business value. It's also a crucial part of planning for a successful

future, including your eventual business exit.

There are many strategies you can use to retain key employees. Today, we will look at some of the pros and cons of a non-qualified deferred compensation (NQDC) plan as a strategy to handcuff key employees.

What Is an NQDC Plan?

An NQDC plan allows employees to defer earnings from one year to a later year.
As an employer, offering an NQDC plan could be an attractive strategy for keeping high-earning key employees dedicated to your business. This, in turn, could help provide more assurance that such key employees will stay with the business as and after you leave it, which could increase the business' value to a buyer.

With an NQDC plan, there are no limits to how much an employee can defer in a given year. When properly created, an NQDC plan could be an attractive strategy for employees to reduce their tax responsibilities in a given year, use their earnings to grow their wealth, and create more flexibility in their financial planning strategies. Companies who can provide this strategy to key employees may find it easier to retain those key employees.

Let's look at some pros and cons of an NQDC plan to help you determine whether it's a strategy you can leverage.

Pro #1: Handcuffs Employees

You're likely familiar with a common qualified deferred-compensation plan: a 401(k). One of the downsides of a qualified deferred-compensation plan is that there are generally caps on how much an employee can defer. Since key employees tend to the high earners, it's likely that they will have maxed out their 401(k) contributions, leaving them with more money they want to invest but fewer avenues to invest it via their employment with your company.

As an employer, you can create an NQDC plan that gives them more ways to grow their while and includes various conditions on the employee. For example, you may create a plan that only allows the employee to access their deferred earnings after you leave the business. You may also include conditions that prevent a key employee from working or consulting with a competitor in order to be eligible for the NQDC plan.

The ability to provide flexibility in terms of the conditions of the NQDC plan could be mutually beneficial. Your key employee could continue to exceed their goals as a condition of the NQDC plan, which benefits your business. Likewise, the employee can invest their deferred compensation pre-tax and in ways that a 401(k) may not allow them to. They could then retrieve those funds at a set date in the future, which locks them in until the date they can access the funds.

Pro #2: Cash Flow & Tax Advantages

For employers, an NQDC plan has an obvious benefit for cash flow. Since earnings that are deferred are not paid until a future specified year within the NQDC plan, it could give a business more access to additional cash.

Though the tax advantages of an NQDC plan are minimal for employers, since the deferred compensation is not tax deductible until it's actually paid out in the future, there are financial benefits to using an NQDC plan. For instance, there typically aren't

any annual fees to pay to manage the NQDC plan, nor do NQDC plans require any kind of filing with the IRS.

A big benefit of an NQDC plan for employees lies in the tax advantages it offers. Earnings that go into an NQDC plan may not be taxed as annual income until those earnings are paid out at a later date. This can allow key employees to reduce their taxes owed until the time when the earnings from the NQDC plan are paid by you, whi9ch could place them in a lower tax bracket. Meanwhile, their deferred compensation may be able to grow, depending on the investment vehicle they use within their NQDC plan.

Pro #3: You Can Choose Who Gets an NQDC

NQDC plans do not fall under the purview of the Employee Retirement Income Security Act (ERISA). As such, you can choose exactly who you want to offer an NQDC plan to. This is different from a qualified deferred compensation plan, such as a 401k, which doesn't allow you to pick and choose who gets access to it.

This can allow you to tailor the NQDC plan to be as attractive as possible to a key employee, with the goal of keeping that employee with your company as you pursue your business and post-business goals.

Con #1: Stringent Adherence to Tax Law

NQDC plans can be flexible for employers and employees. However, tax law is stringent on how you and a key employee create the NQDC plan.
For instance, all plans must be in writing. They must include a future date upon which the employee can access their deferred compensation. This date may be a fixed date in the future, the day you sell the business, or upon the death of the employee, for example.

Additionally, employees bound by an NQDC plan may not access the funds until the date within the written plan. So, if a key employee faces a financial crisis and wants to access their deferred funds through the NQDC plan early, there is no recourse they have to access those funds in general. It's important that any key employee with whom you create an NQDC plan understands this.

Violating the stringent requirements of an NQDC plan could create financial burdens for both you and the employee you're trying to handcuff. Be sure to consult with a tax advisor before you offer any kind of NQDC plan to an employee.

Con #2: No Financial Hardship Protections

The most common type of NQDC plan is an unfunded plan. Unfunded plans usually do not have money set aside to pay the employee at a later date. In other words, deferred earnings in an NQDC plan are still a part of your business' general liabilities.
This means that if your business were to face financial hardships, such as bankruptcy, you may need to use your employee's deferred earnings to address those financial hardships. This could damage your relationship with your key employees or cause your business to lose them entirely, which may have a negative domino effect for your business and planning.

We strive to help business owners identify and prioritize their objectives with respect to their businesses, their employees, and their families. If you have questions on this

topic, we can help with more information or a referral to another experienced professional.

The information contained in this article is general in nature and is not legal, tax or financial advice. For information regarding your particular situation, contact an attorney or a tax or financial professional. The information in this newsletter is provided with the understanding that it does not render legal, accounting, tax or financial advice. In specific cases, clients should consult their legal, accounting, tax or financial professional. This article is not intended to give advice or to represent our firm as being qualified to give advice in all areas of professional services. Exit Planning is a discipline that typically requires the collaboration of multiple professional advisors. To the extent that our firm does not have the expertise required on a particular matter, we will always work closely with you to help you gain access to the resources and professional advice that you need.
This is an opt-in newsletter published by Business Enterprise Institute, Inc., and presented to you by our firm. We appreciate your interest.
Any examples provided are hypothetical and for illustrative purposes only. Examples include fictitious names and do not represent any particular person or entity.

Newsletter published by Business Enterprise Institute, Inc., and not associated with Scott Jones Financial. The information contained in this article is general in nature and is not legal, tax or financial advice. For information regarding your particular situation, contact an attorney or a tax or financial professional. The information in this newsletter is provided with the understanding that it does not render legal, accounting, tax or financial advice. In specific cases, clients should consult their legal, accounting, tax or financial professional. Any examples provided are hypothetical and for illustrative purposes only.

Scott Jones Financial | Visit Our Website!

Securities Offered Through Valmark Securities, Inc. Member FINRA, SIPC
Investment Advisory Services Offered Through Valmark Advisers, Inc. a SEC Registered Investment Advisor
130 Springside Drive, Suite 300 Akron, Ohio 44333-2431 | 1-800-765-5201.
Scott Jones Financial is a separate entity from Valmark Securities, Inc. and Valmark Advisers, Inc.
Business Enterprise Institute, Inc. is not affiliated with Valmark Securities, Inc. or Valmark Advisers, Inc.

Certified Financial Planner Board of Standards Center for Financial Planning, Inc. owns and licenses the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™, and CFP® (with plaque design) in the United States to Certified Financial Planner Board of Standards, Inc., which authorizes individuals who successfully complete the organization’s initial and ongoing certification requirements to use the certification marks.

Scott Jones Financial | 5950 Fairview Rd., Ste. 402 | Charlotte, NC 28210 US

Unsubscribe | Update Profile | Constant Contact Data Notice

Try email marketing for free today!