Custodial Executive Bonus

[Music begins]

Narrator: Hello, this is David Szeremet with the Advanced Planning team here at AuguStar Life. And today, I want to share a recent case I worked on, because it really illustrates the power of permanent life insurance in business markets. I recently received a call from an agent in California, and he has a business owner client.

[Music ends]

It's actually a husband and wife business and they are in the consulting business.

They actually consult with other small businesses on things like tax matters, licensing permitting. You know, there's there they are what you would call like business concierge services. And, one of their employees is a CPA who works on the tax side, and the CPA is earning $150,000 a year. But the business owners are worried that the CPA will be poached.

This has happened to them in the past, and they don't want to lose this person. You know, they they've gone down this road before, and they want to make sure that they give something above and beyond to retain and reward the employee. But of course, they want to be selective. You know, they don't want to cover everybody in the business.

They have about ten other employees. They also want a current tax deduction. And they're not looking for thousands of dollars of, legal and administrative fees. So yes, we talked about concepts such as split dollar life insurance and supplemental executive retirement plan, also known as deferred comp. And they just weren't interested in plans that are that costly and that complicated.

So where we ultimately concluded and it was the best solution for them is what we call custodial executive bonus. So under the custodial executive bonus plan the business will be bonus $10,000 a year to the employee. And the employee will apply for and personally own a life insurance policy, in this case, permanent life insurance. The accumulation IUL product with AuguStar, which I call the accumulation all star.

It's very competitive. It provides very strong death benefit and great potential to accumulate cash value to use as a retirement supplement. In the end, that employee will own the policy. However, it will be subject to a custodian, custodianship or restrictive agreement. Basically, it's a one page document that is sent in to us, and if the employee tries to access any cash value from the policy, it is restricted.

So if we boil down the benefits for the employer, what do they get? Well, it's that retention and reward mechanism they're looking for. So they like that also it's simple. It requires very little legal or administrative work as compared to the other fringe benefit plans out there like split dollar or SERP. It's selective. So they get to pick and choose the participants.

In this case, they only wanted to cover the CPA. That's fine. Now, if they wanted to cover everybody in the business with a bonus, they could do that too. So you can go to both extremes. You know, cover one person or cover everybody. In this case, they just wanted to go with the one employee here, to make sure that that retention and reward mechanism is in place.

The business will also receive a current tax deduction, as long as the bonus is reasonable and necessary. And you know, again, in this case, the employee is earning $150,000 a year. The bonus will be $10,000 a year. So it's less than 10% of the employee's base salary. So, you know, this is not going to create any red flags with the IRS.

So the deduction really should be no problem there. And again it adds that element of control with the custodianship. So again from the employer's perspective simple selective current tax deduction and control. So the employer the employers are thrilled about this plan. But let's flip the coin over and talk about the employee. What does the employee get out of this.

Why is he excited. Well I'll tell you why. He gets permanent death benefit protection, which as we all know, most Americans are grossly under insured. So this provides good protection for he and his family. Also, let's not forget about the cash accumulation potential with our IUL accumulation product. That employee, you better believe it. He's looking at that cash surrender value column.

And, you know, he's very excited about the prospect of accessing that in retirement, as a retirement supplement. And as long as he does it properly through withdrawals to basis and or policy loans, and as long as he keeps the policy in force and it's not a modified endowment contract, then this should be nontaxable cash flow in his retirement.

Now, when does this restriction get removed? In this case, the employee is age 50. So the employer is using a 15 year custodianship. So at age 65 you know, normal retirement age, the restriction rule will be removed and the employee will then have unfettered access to the cash value. As long as that custodianship is in place, the employee's access is restricted.

Now, people always ask me, well, what happens if he were to leave like in year five or year six and goes across the street and sets up a competing consulting business and tries to access that cash value? Well, the answer is he can't access it until the restriction is removed. And as I mentioned in this case, they're going with the 15 year restriction, you know, at age 65 for this employee.

So even if the employee leaves, yes, they take the policy with them. Yes, they personally own it, but they still can't access the cash value until the restriction is removed. Another question I get, but what if the employee's daughter is getting married and they wanted to access some cash value, let's say in year ten for her wedding?

Or they need to … they're buying a new house or something. The answer is the employer always has the ability to remove the restriction early if they want to. So the employer holds the cards here. I have had cases where the employer removed the restriction for a wedding. And then as soon as the policy was accessed after the wedding, they put a new restriction back on to reinstitute the custodianship.

So that's totally fine. They can do that. The employer has the ability to do that. So there you have it a great plan. Simple selective current tax deduction and control for the employer for the employee permanent life insurance, death benefit protection and the potential for cash accumulation as a retirement supplement. Both sides win this deal.

[Music begins]

If you need more about this concept, please reach out to us.

We have guides, brochures, sample legal documents, educational tax sheet, you name it, we've got it. And we would love to talk to you through cases. So please reach out to the Advanced Planning Department. We have attorneys ready, willing and able to assist you. So go out there, help those business owners, you know, go get them.

[Music ends]