Episode #169: How to Use Life Insurance to Retain Key Employees

Video Transcription

Hi, my name is Kyle. Welcome back to another episode of "Money Script Monday." Today, we're going be talking about how to use life insurance to retain key employees. So, yes this episode is for you, the business owner to learn strategies to retain key employees, but also to attract new talent to your firm. So, I'm going to show you a very clear and concise method, a plan that requires no IRS approval and provides an immediate tax deduction to your firm, which of course is a win for you and a win for the employee. Let's start first the challenges that you face in the marketplace today from big picture items such as profitability, keeping the lights on, all the way to routine tasks such as customer service and employee engagement. I mention employee engagement because loyalty is at its all-time low. Individuals, employees are prioritizing their personal advancement compared to just spending it with a company for 20, 30, 40 years. So what we have to prioritize here is the importance of retaining these key employees because the out of pocket cost can be significantly more if we're losing one of these individuals and have to put the time and effort to find a new one. So that's where fringe benefits come in place, you may have these already and there's a theory of spending more upfront for that employee to extend a further handshake to create better loyalty for the firm.

And again, that's putting more effort, more money upfront, which again hopefully will save you money in the long run. And that in HR terms, that's where the retaining aspect comes into play. Let's take a look at C-suite executives, a lot of times employers, the first thing that comes to their mind is deferred comp, and there's pros and cons to it. There's two types as well: qualified, and non-qualified. Qualified, of course, there's contribution limitations, it's insufficient, it's really not that enticing to that executive. Then, there's non-qualified deferred comp which is a bit more suitable, but there's vesting schedules, there's salary reductions, the big problem with that is, of course, there's no immediate deduction. There's investment strategies you have to worry about, there's cash reserves, and there's a future liability risk of paying out those promised benefits. So what's the solution? Well, there's an innovative one and it's called the executive bonus plan and we're funding a life insurance contract to index your universal life policy specifically to provide for that executive future cash valued tax-free income along with the death benefit to pass to their family.

Let's move on over to the board here and talk more about Section 162 of the IRS Code where it states how we're able to leverage this bonus. And essentially, companies are able to write off any essential or necessary expenses during that year including compensation, and it has to be reasonable of course, it has to make sense and fall within certain thresholds of what that employee is currently making already. So, in this flow chart, we have a business entity, LLC S-corp or C-corp that's going to give a bonus to their executive. That bonus is a tax write off for that company in that year, and that bonus is 100% taxable that year for the employee. Now, of course, what does that employee do with that bonus? Well, they're redirected right to the insurance company as a form of a premium payment, sometimes the employer pays that directly to the insurance carrier, but it's safe to go through the bank account of the executive first. Of course, that executive has to pay income on that bonus that they receive and the remaining amount, of course, would go to that life insurance policy that he owns outright and of course any cash value and death benefit is ultimately his.

Let's move on over to the other side of the board here and walk through the advantages and the disadvantages of the employer and the employee. The first advantage for the employer is that tax deduction. Obviously, that's what that employer is doing here and so that's a benefit to them, and of course, it's a benefit because it keeps that employee happy and keeps them with the company. Ease of implementation. Essentially, it's hands-off, you have them complete an application with the insurance carrier and the carrier does the rest. Administrative flexibility, this is where it's different than deferred comp because we can be discriminatory, you can choose which employees receive what bonus, and that gives a little bit more again, flexibility for yourself the business owner. No IRS consent, you don't have to tell them when you're setting these up or terminating them on behalf of the employee, and of course, there's key employee retention methods that you can use. Now, I'm going to talk, go right into the disadvantage because normal executive plans give the employee the outright ownership. I put an asterisk here because there are certain restrictions that the employee can create which limits when they can access that cash value. What that does though is it creates an additional layer of legal paperwork that you'd want to have in place but again, it can be done and certainly is possible. For the employee, it's customizable, they can choose how to fund these policies, they can choose who to assign as their beneficiary. So that's key. It's theirs at the end of the day. Management of income taxes, and of course, that risk. Well that's could be considered a liability but in this case, it's an asset, it's completely theirs, it's not an expense. Some employers even gross up the bonus which can help offset that tax liability where essentially giving them a second bonus to pay that tax.

The third one is sole ownership, I have mentioned this multiple times already. It's- the employer is nowhere involved in this contract, it's solely yours. If you left the company, it'd be in your name 100%. And of course, the cash value, living benefits, and the death benefit are just cherries on top, that's why we're doing this is to create supplement retirement income for yourself and that employee, but the disadvantage there is, of course, that taxable income that you'll have to pay your marginal tax rates at. So we talked about some of the challenges that you face, we talked about a flowchart giving you an idea of the logistics of how this works and then the benefits and the advantages, disadvantages from the employer to the employee. And I will say this, again, it's easy to implement and to get started right away, so I'd encourage you to call a financial advisor to run some numbers and some designs. All you would need to equip them with is their name, date of birth, health, sex, the bonus that you feel comfortable in paying, and what those employee and employer tax brackets are so that the financial advisor knows how to build out these plans accordingly. And with that, I want to thank you for your time. Again, my name is Kyle. Enjoy your day.