

LIFE ADVANCED MARKETS

Nonqualified deferred compensation using life insurance (single employee): Example agreement

Outlines the terms, conditions, and obligations between the employer and key employee regarding the compensation arrangement

Using this nonqualified deferred compensation (NQDC) plan, specific key employees may defer a portion of their income – such as salary, bonuses, or commissions – to be paid at a future date, typically upon retirement or separation from service.

The employee does not pay income taxes on any amounts deferred until such time as the employee receives the deferred compensation.

Unlike qualified plans (e.g., 401(k) plans), NQDC plans do not have to comply with ERISA¹ requirements, allowing for more flexibility in terms of design and participation criteria. NQDC plans do not have IRS contribution limits, and are typically unfunded, meaning the money remains part of the company's general assets and is subject to creditor claims in bankruptcy. However, employers may often choose to purchase life insurance policies on the lives of the plan participants in order to provide the liquidity necessary to pay the deferred compensation to the participants in the future per the terms of the plan.

Keep in mind that any strategy that includes life insurance is contingent on the health underwriting of the insured and financial underwriting. Employers should consult with financial professionals and tax professionals to determine whether it is an appropriate strategy for their specific situation.

All legal documents need to be drafted by an attorney; this example is provided as a reference for your discussions.



Indexed Universal Life (IUL)

With its death benefit protection, accumulation potential, and the opportunity for loans and withdrawals, IUL can be a valuable tool for small businesses to address key-employee compensation, business succession, and business-owner estate-planning strategies.



NEED ADDITIONAL HELP? Call the Life Case Design Team at **800.950.7372**.

¹Employee Retirement Income Security Act of 1974

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Clients should consult their own legal counsel to ensure that any agreements meet their specific needs and comply with applicable laws and regulations. The provision of this specimen document does not imply endorsement or approval of any specific terms or conditions contained within it. It is not adapted to the specific circumstances or objectives clients may have.

Allianz Life Insurance Company of North America does not provide financial planning services.

Indexed universal life (IUL) insurance policies provide a death benefit that is generally paid income-tax-free to beneficiaries, and the potential to build tax-deferred accumulation value. IUL requires qualification through health and financial underwriting.

Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy. If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change, and you should consult a tax professional.

Product and feature availability may vary by state and broker/dealer.

Guarantees are backed solely by the financial strength and claims-paying ability of Allianz Life Insurance Company of North America.

Products are issued by Allianz Life Insurance Company of North America, 5701 Golden Hills Drive, Minneapolis, MN 55416-1297. 800.950.1962 www.allianzlife.com

This content does not apply in the state of New York.

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DEFERRED COMPENSATION AGREEMENT

(for use only in situations where the stock of the employer is not publicly traded)

This Agreement (the "Deferred Compensation Agreement") is made and entered into effective as of the _____ day of _____, 20____, (the "Effective Date") by and between _____ (together with any affiliated companies hereinafter collectively referred to as the "Employer") and _____ (hereinafter referred to as the "Employee").

RECITALS

- A. [The Employer has extended an offer of employment to the Employee to serve as _____, commencing as of _____, 20____] [Employee has been employed by Employer for _____ years and during that time has provided valuable services to Employer and the Employer desires to continue to benefit from Employee's services];
- B. The Employer has determined that Employee is among a select group of management or highly compensated employees of the Employer;
- C. The Employer and the Employee are willing to enter into this Agreement on the terms herein set forth, effective as of the date hereof;
- D. Employee desires to defer a portion of Employee's compensation and the parties to this Agreement wish to agree upon the terms and conditions under which the Employee can defer compensation; and
- E. The Employer and Employee intend, by this Agreement, to create a nonqualified deferred compensation arrangement to provide deferred compensation benefits to the Employee.

NOW THEREFORE, in consideration of the mutual promises contained below, the parties agree to the foregoing and as follows:

1. ELECTION TO DEFER COMPENSATION.

- A. **Election to defer.** On or after the Effective Date of this Agreement, the Employee may file a written election with the Employer in the form provided by the Employer for such purpose to defer up to _____ percent (____%) of the Employee's total annual compensation, including salary and bonuses, as determined for the calendar year for which the election is made. An initial election to defer annual compensation must be made within thirty (30) days after the Effective Date of this Agreement on an election of deferral form provided by the Employer for such purpose, which identifies the amount of the Employee's compensation to be deferred. After the initial election to defer annual compensation is made, any subsequent election to defer annual compensation must be made and the Employer notified of such election no later than December 15 to be effective for the following calendar year. Each election to defer the receipt of annual compensation must be made before the beginning of the calendar year in which the compensation is earned and shall remain in effect, unless terminated or changed, or until the date the Employee ceases to be an employee of the Employer.

- B. **Election becomes irrevocable.** Any election to defer compensation, or election to discontinue or modify the deferral, becomes irrevocable for the calendar year for which such election is effective. As of December 15 each year, if a deferral election is then in effect (i.e., has not been amended, revoked, or otherwise terminated), such election shall become irrevocable as it applies to Employee compensation earned and payable in the following calendar year.
- C. **Deferral amount credited to deferred compensation account.** Such amount shall be credited to a Deferred Compensation Account as provided in Section 2 hereof.
- D. **Termination or change of deferral election.** Employee's initial deferral election and any subsequent deferral election shall continue in effect until the first to occur of the following:
 - i. The Employee executing and delivering a notice of discontinuance of the election to the Employer;
 - ii. The Employee executing and delivering a new election of deferral to the Employer;
 - iii. The Employee's separation from service with Employer.

Any election termination or change of a deferral election must be made on a form provided by the Employer for such purpose and may only be made with respect to salary which will be earned on and after the January 1 following the Employer's receipt of such form, provided that such form is received not later than the December 15 which is prior to the applicable January 1.

2. DEFERRED COMPENSATION ACCOUNT.

- A. **Books and records.** The Employer shall maintain on its books and records a Deferred Compensation Account to record its liability for future payments of deferred compensation and interest thereon required to be paid to the Employee (or to the Employee's beneficiary) pursuant to this Agreement.
- B. **Employee's status as an unsecured general creditor.** The Employer shall not be required to segregate or earmark any of its assets for the benefit of the Employee or his beneficiary. The amount reflected in said Deferred Compensation Account shall be available for the Employer's general corporate purposes and shall be available to the Employer's general creditors. The Employer's payment obligations to Employee, or Employee's beneficiaries under this Agreement, constitute an unfunded, unsecured promise to pay benefits in the future. The Employee and the Employee's beneficiaries are unsecured general creditors of the Employer. Accordingly, neither the Employee nor the Employee's beneficiaries shall have any right, secured interest in, status as a secured party or lien-holder, or other interest in any specific asset of the Employer under this Agreement. Employer's payments to Employee under this Agreement shall be made from the general, unrestricted assets of the Employer.
- C. **[OPTIONAL PROVISION:] Establishment of rabbi trust.** Notwithstanding the foregoing, in order to pay amounts which may become due under this Agreement, the Employer may establish a grantor trust (hereinafter the "Trust") within the meaning of Section 671 of the Internal Revenue Code of 1986, as amended. The assets in such Trust shall at all times be subject to the claims of the general creditors of the Employer in the event of the Employer's bankruptcy or insolvency, and neither the Employee nor any beneficiary shall have any preferred claim or right, or any beneficial ownership interest in, any such assets of the Trust prior to the time such assets are paid to the Employee or beneficiary pursuant to this Agreement.
- D. **Interest credited on deferred compensation amount.** The Employer shall credit the deferred compensation amounts pursuant to Section 1 hereof with interest at the fixed rate of ____ percent (____%) per annum, compounded annually at the end of each calendar year. The Employer has no obligation to invest the Employee's deferred compensation account in any particular investment.

3. DISTRIBUTION OF DEFERRED COMPENSATION BENEFITS.

- A. **When benefits become payable.** Upon the Employee's separation from service, Employee shall be entitled to receive payment of the entire amount of the Employee's deferred compensation account, including accrued interest. Distribution will commence within an administratively reasonable time following the end of the year during which the benefits became payable, provided however that in all events distribution will commence by the 15th day of the third calendar month following the end of the year during which the benefits became payable.
- B. **Distribution of benefits.** The Employee shall elect to receive distribution in one of the following forms:
- i. a single lump-sum distribution in cash;
 - ii. an installment distribution consisting of approximately equal annual cash installments over a five-year period.
- C. **Election of distribution.** Employee shall elect a method of distribution at the time the individual first becomes eligible to defer compensation and shall notify Employer of such election in a written election form provided by the Employer for such purpose. Any such election shall remain in effect until the election is properly modified or revoked in the manner prescribed herein. Notwithstanding the foregoing, where the Employee's benefit amount is \$50,000.00 or less at the time the first distribution payment is to be made, distribution of that benefit amount will be made in a single lump sum.
- D. **Distributions to beneficiaries.** If Employee dies before distributions of the Employee's benefit amount have started, then the Employee's benefit amount shall be distributed to the Employee's designated beneficiaries in a single cash lump sum within administratively reasonable time following the end of the year during which the Employee died, provided however that in all events distribution will commence by the first day of the third calendar month following the end of the year during which the Employee died. If the Employee dies after distributions to the Employee have begun but before the entire benefit amount has been distributed to the Employee, then the remaining portion of the Employee's benefits under this Agreement shall be distributed to the Employee's beneficiaries in the manner specified on the beneficiary designation form then in effect.
4. **BENEFICIARY.** The Employee has notified, or will in the future notify the Employer, of the person or persons entitled to receive payments on the death of the Employee by giving Employer notice of such change on a beneficiary designation form provided by the Employer for such purpose. For the purposes of this Agreement, such person or persons are herein referred to collectively as the "beneficiary." The person whom an Employee designates as beneficiary for this purpose must be one of the following:
- A. the Employee's spouse;
 - B. the Employee's father and/or mother;
 - C. the Employee's sibling;
 - D. the Employee's child; or,
 - E. a legal ward living with, and dependent upon, the Employee at the time of Employee's death.

If the Employee dies and has not designated a beneficiary, the Employee's beneficiary shall be the Employee's surviving spouse, or if the Employee has no surviving spouse, then the Employee's beneficiary shall be deemed to be the Employee's estate. An Employee's beneficiary designation may be changed at any time by the Employee giving written notice to the Employer of such change on a beneficiary designation form provided by the Employer for such purpose. The rights of any beneficiary presently or hereafter designated are subject to any changes made in this Agreement by the Employee and the Employer.

5. **TAX WITHHOLDING.** The Employer shall be permitted to withhold from any payment to the Employee or the Employee's beneficiary hereunder all federal, state, and other taxes which may be required with respect to such payment.

6. **MISCELLANEOUS.**

- A. **Successors and assigns.** This Agreement shall be binding upon the parties hereto, their heirs, executors, administrators, successors, and assigns. The Employer agrees that it will not be a party to any merger, consolidation, or reorganization unless and until its obligations hereunder shall be expressly assumed by its successor or successors.
- B. **Non-transferability, non-assignment of benefits.** The benefits to the Employee under this Agreement are not transferrable or assignable. Neither the Employee nor the Employee's beneficiary shall attempt to assign, transfer, pledge, or encumber any payments payable to the Employee or the Employee's beneficiaries hereunder. Any attempt to assign, transfer, pledge, or encumber benefits hereunder shall be void or voidable.
- C. **Notices.** Any notice, consent, or demand required or permitted to be given under this Agreement shall be (i) in writing and (ii) signed by the party giving or making the same. If such notice, consent, or demand is mailed to a party, it shall be sent by United States certified mail, postage prepaid, addressed to such party's last known address as shown on the records of the Employer. The date of such mailing shall be deemed the date of notice, consent, or demand.
- D. **No guaranty of employment.** The Employee shall have no guarantee or right to employment, or continued employment, by reason of this Agreement. Nothing in this Agreement shall be construed to create a contract of employment between Employer and Employee. This Agreement shall not supersede any contract of employment, whether oral or written, between the Employer and the Employee, nor shall it affect or impair the rights and obligations of the Employer and the Employee, respectively, thereunder. Nothing contained herein shall impose any obligation on the Employer to continue the employment of the Employee.
- E. **Cooperation.** The parties agree to take such actions as are desirable to allow the rights and duties specified in this Agreement to be brought into effect. The parties each agree to execute and deliver all documents which may be desirable to bring into effect the intent of this Agreement or to carry out its provisions.
- F. **Construction.** The language used in this Agreement shall be deemed to be the language chosen by the parties to express their mutual intent, and no rule of strict construction shall be applied against any party.
- G. **Severability.** Whenever possible, each provision of the Agreement shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision shall be held to be prohibited by, or invalid under, applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

- H. **Liability of insurer.** To the extent that Employer may purchase life insurance on the life of the Employee, the insurer issuing such policy shall have no liability except as set forth in the policy and shall be fully discharged from its obligations under such policy by payment of all policy death benefits to the beneficiary or beneficiaries named in the policy subject to the terms and conditions of the policy. The insurer shall have no obligation to inquire into or take notice of any of the covenants herein contained as to the policy or as to the application of the proceeds of the policy. In no event shall the insurer be considered a party to this Agreement or any amendment hereof. No provision of this Agreement, nor of any amendment hereof, shall in any way be construed as enlarging, changing, varying, or in any other way affecting the obligations of the insurer as expressly provided in the policy.
- I. **Governing law.** This Agreement, and the rights of the parties, shall be governed by, and construed in accordance with, the laws of the state of _____.
- J. **Headings.** The headings in this Agreement are for convenience only and shall be ignored in the construction of this Agreement.
- K. **Counterparts; facsimile; electronic transmission.** This Agreement may be executed in counterparts (each of which shall be deemed an original, but all of which taken together shall constitute one and the same agreement) and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other parties. The exchange of copies of this Agreement and of signature pages by facsimile or electronic transmission shall constitute effective execution and delivery of this Agreement as to the parties and may be used in lieu of the original Agreement for all purposes. Signatures of the parties transmitted by facsimile or electronic transmission shall be deemed to be their original signatures for all purposes.
- L. **Amendment.** This Agreement may be amended at any time by mutual written agreement of the parties hereto, but no amendment shall operate to give the Employee, or any beneficiary designated by him, either directly or indirectly, any interest whatsoever in any funds or assets of the Employer, except the right to receive the payments herein provided.
- M. **Compliance with Internal Revenue Code Section 409A.** This Agreement has been prepared with reference to Internal Revenue Code Section 409A and the regulations thereunder and should be interpreted and administered in a manner consistent with Section 409A. The Employer will use its best efforts to administer this Agreement in a manner which complies with the requirements of Internal Revenue Code Section 409A and the regulations thereunder.
- N. **Suspension of deferrals.** Deferrals under this Agreement may be suspended by the Employer effective as of any January 1 following the time that tax or other laws are enacted or interpreted which result or will result in costs to the Employer significantly in excess of those contemplated at the time of the execution hereof. In the event of such suspension, the Employer's sole obligation shall be to pay to the Employee in accordance with Section 3 above. In no event may deferrals be ceased during a calendar year by action of either the Employer or the Employee, or both.

IN WITNESS WHEREOF, the parties hereto have set their hands and seals, the Employer by its duly authorized officer, on the day and year above written.

EMPLOYEE:

Signature

Insured employee printed name

EMPLOYER:

Signature of authorized officer

Authorized officer printed name

Officer title

