Life Advanced Markets

TARGET MARKETING:

Technology Industry

2021: 3Q - 4Q

TECHNOLOGY	
Industry	The Technology Sector comprises a wide variety of business types which offer services and manufacture products based on advanced and complex technologies. These activities require a high degree of technical skill, professional expertise, and complex equipment. Businesses in this sector rely heavily on the use and adoption of services and products provided by entities in nearly every other sector, including manufacturing, agriculture, and professional services.
Trends	Valuation remains a consistent issue for technology business owners. The sources of value for technology businesses can include varied assets such as intellectual property, proprietary products or information, development or service contracts, as well as key personnel and leadership. Consistent sales of technology companies provides a source of information regarding current valuation (which must be monitored closely as metrics and multipliers change quickly in this industry). Significant proposed infrastructure spending will impact many areas of the technology sector, particularly from extensive investment in developing technologies for electronic vehicles, and expanding domestic semiconductor development and production. Many technology companies, even currently "small" companies, continue to form and operate as C-Corporations for the purpose of generating funding for planned growth. Corporate tax rates continue to be favorable (21% compared to personal rates up to 37%), but proposed future tax changes may cause re-evaluation. The technology segment utilizes "gig" workers, or freelancers, more than most industries. The pandemic has accelerated this trend. These workers are typically independent contractors, which means they do not participate in qualified retirement plans.
Concerns	**Constant disruption** in the technology space leads to a high turnover in technology companies as advancements are surpassed and once-thriving companies find themselves made obsolete. Company founders **frequently rely on private equity investors** during the growth phase of their businesses. These investors are frequently active in influencing the operation of the business to maximize value, including replacing founders and forcing sales of the business. President Biden has proposed a significant **increase in capital gains tax rates** to 39.6%. For technology companies, which can often sell highly appreciated stock, this increase would create a notable challenge to owners. **Ageism** in the technology segment means something different than it does in other industries. According to a study conducted by Visier, the average age of a tech manager is 42, while the average age of a manager in a non-tech industry is 47. And employees in the technology industry advance at a faster pace than those in the non-tech industry. Younger managers have a tendency to be more transient, which presents a challenge for businesses looking to retain and motivate key employees.

[1] Fact Sheet: The American Jobs Plan, 3/31/21, https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/

[2] Biden's plan raises top capital gains tax rate to among highest in world, 6/21/21, https://www.cnbc.com/2021/06/21/biden-tax-plan-raises-top-capital-gains-dividend-tax-rate-to-among-highest-in-world.html

[3] Visier Insights™ Report: The Truth About Ageism in the Tech Industry, https://www.visier.com/wp-content/uploads/2017/09/Visier-Insights-AgeismInTech-Sept2017.pdf

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ISSUE	OPPORTUNITY
The likelihood of substantial capital gains tax increases makes sales of highly appreciated company stock more costly.	**Charitable Remainder Trust (CRT):** Look for opportunities to defer and reduce annual recognition of capital gains, as well as provide additional deductions. A CRT in combination with a wealth replacement ILIT should have appeal.
The technical nature and rapid change inherent in these businesses may limit the available competent successors. Companies must be competitive to retain key employees.	**Key Employee Compensation:** Strategies should be developed to recruit and retain employees with the requisite expertise to maintain the growth of the business. **Business Continuation "Bonus" Plan:** Key employees should be incentivized to remain with the business in the event of a sale or transfer in order to preserve the business' value.
The frequency of sales and acquisitions in the technology industry requires these companies to work actively to maximize their ongoing value.	**Key Employee Compensation Plan Design:** Ensure that covered key employees are discouraged from accessing their NQDC balances in the event of an acquisition by eliminating "change of control" language. Consider restrictive key employee bonus plans to motivate key employees to remain loyal employees.
Owners' net worth may be tied largely to the value of their business (which they likely overestimate or do not know); owners may lack sufficient retirement plan funding.	**Buy-Sell Agreement:** Life insurance funding of the agreement can provide both for a death benefit, which is generally passed income-tax-free to beneficiaries, to cover obligations under the agreement, as well as allow access to policy cash values through policy loans and withdrawals to potentially help supplement retirement planning.

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.

ADDITIONAL TALKING POINTS / PLANNING OPPORTUNITIES:

Young employees value different compensation benefits.

Employees at tech companies are generally younger than their counterparts at non-tech companies, even at the higher levels of management. This also tends to apply to the business owners themselves.

From a key employee compensation standpoint, 35- to 45-year-old employees may place a higher value on certain forms of compensation than those in the 45- to 55-year-old range. For example, the younger age group may be more interested in life insurance protection and tax-favored cash values than they are building a retirement nest egg. Therefore, they may find a key employee bonus plan more appealing than a nonqualified deferred compensation plan.

From a business succession/estate planning standpoint, younger owners may be more concerned about maximizing their after-tax income than they are about passing the business down to the next generation of family members.

Consider strategies such as a partnership/LLC buy-sell agreement that provides death benefits – which are usually passed on to the beneficiary income-tax-free – to meet buy-sell obligations while allowing the owners to accumulate funds in a cash-value life insurance policy on a tax-favored basis; the funds can be accessed through policy loans and withdrawals to potentially help supplement retirement planning.

Or consider a spousal lifetime access trust that may provide needed death benefit/income protection for their family, while providing access to policy cash values indirectly via their spouse. Such strategies may be more appealing than an irrevocable life insurance trust solely meant for estate planning purposes.

Headwinds against noncompete/restrictive employment contracts

President Biden recently signed an executive order promoting competition in the American economy. One item of note is that the order "Encourages the FTC to ban or limit noncompete agreements." In addition, numerous states have recently banned the use of noncompetes and/or watered down their effectiveness. While the goal of such restrictions may be to prohibit or curb the use of noncompetes for rank-and-file employees, not executives, employers may soon need to reevaluate the effectiveness of all their noncompete agreements. This creates an opportunity to start a discussion with your business clients regarding effective ways to attract, retain, and motivate key employees using life insurance-based key employee compensation plans; remind them that while noncompetes may be the stick, key employee compensation plans may be the carrot that motivates employees to remain loyal. Nonqualified plans that provide a "golden handcuff," or a financial reward for remaining with the business for a period of time, may be appealing as a complement to restrictive employment agreements which may be challenged.

Tax avoidance/delay strategies

Business owners are likely to be introduced to various strategies for delaying or avoiding taxes upon the sale of their business interest. This is especially true in a segment that generally has a shorter business lifecycle, such as the technology industry. Strategies that may be appealing to these clients include Incomplete Non-Grantor Trusts which are intended to avoid state income tax in highly taxed states, private annuity trusts (which have drawn the ire of the IRS), or Deferred Sales Trusts (not approved by Allianz) which are marketed as a means to delay capital gains taxes under IRC §453. Financial professionals should be aware of such strategies, their purported advantages, and their risks.

RESOURCES: Click these links to learn more.

- Technet
- American Council for Technology and Industry Advisory Council

To learn more, contact the Advanced Sales and Practice Platform team at 800.800.3220 or AdvancedStrategies@allianzlife.com

Fixed index universal life insurance requires qualification through health and financial underwriting.