

February 26, 2013

Compensation Strategies for a High Tax Environment



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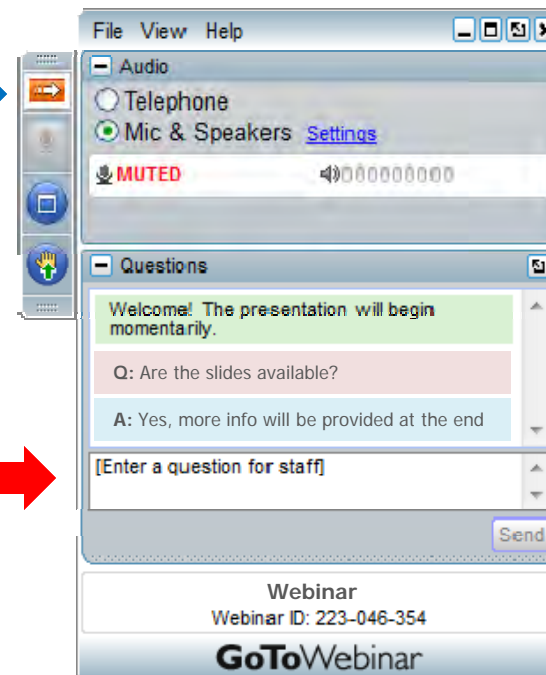
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We're happy to provide a copy of today's slides.
Information will be provided at the close
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today's presentation:** 
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What problem are we trying to address?

Creating a compensation strategy
that strengthens the employer-
employee partnership in a world of
high taxes



Current Taxes for High Earners

Federal Marginal Rate	39.6%
State Marginal Rate	12.3% (Ca)
Federal Capital Gains Rate	20.0%
State Capital Gains Rate	5% (avg)
Medicare Tax	2.35%
Medicare Surtax	3.8%

Disclaimer

- Taxes are more complicated than ever
- Don't rely on the information that follows to make your personal tax planning decisions

Reality

The more successful your employees are (i.e., the more they earn), the lower the percentage of income they will take home.

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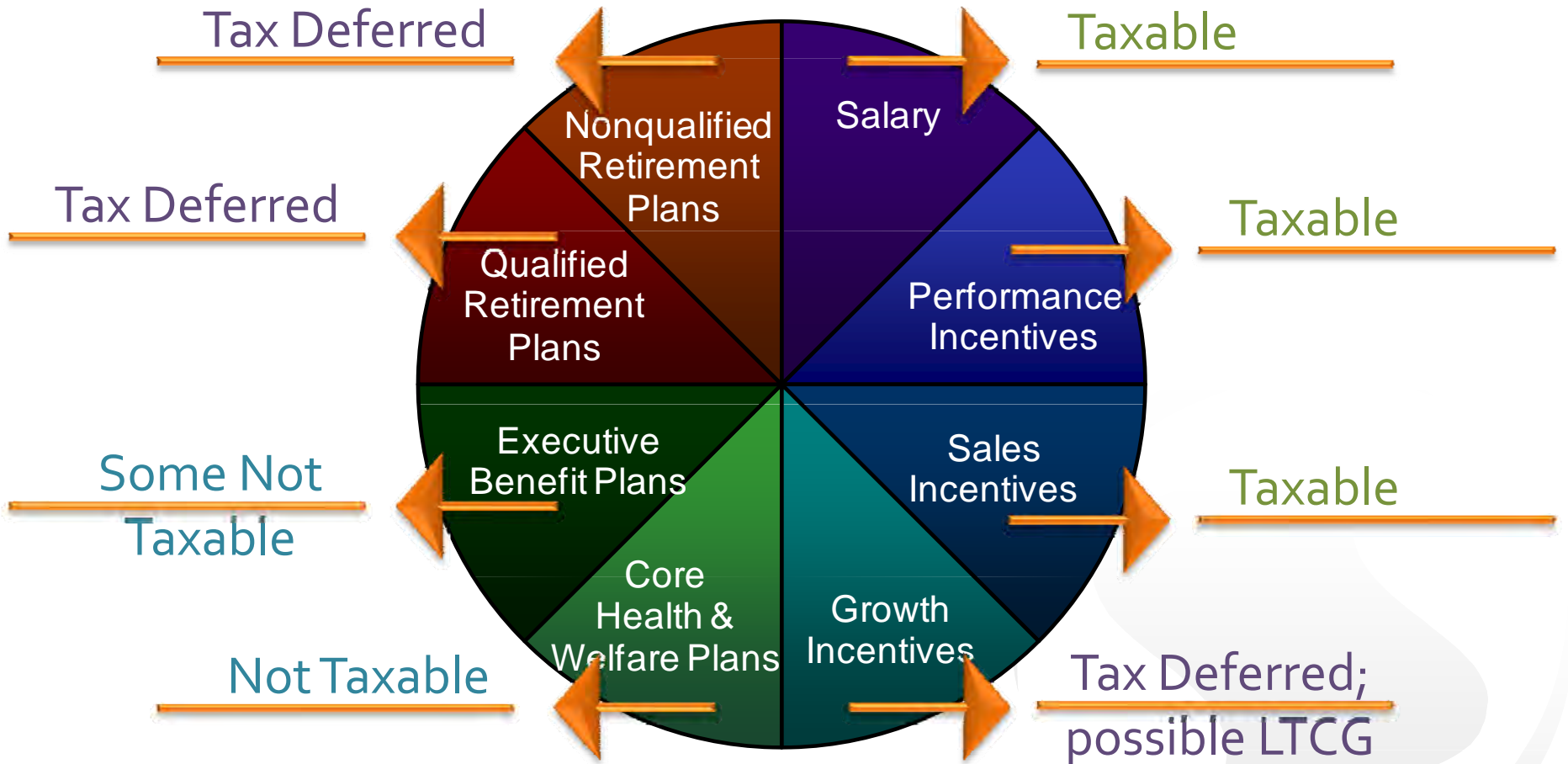
Is there an opportunity here?

Preferred Tax Result

Tax Free

Tax Deferred

Total Compensation Allocation



Unique Partnership Statement

“Here’s what we do that demonstrates our belief that you are a partner in our business success.”



Demonstrating Partnership Compensation

- “You share in the economic value you help create”
- “Your compensation structures mirror the way owners are paid”
- “You have variable pay opportunities that are not ‘capped’”
- “You participate in equity or equity like programs that have significant upside”
- “If we sell the company, you’ll participate in the value created”
- “If we can create tax-savings opportunities for you, we’ll do it”
- “Your compensation package won’t be replaceable anywhere else”



The Results of a Partnership Compensation Package



Cost of Turnover

- Average cost of replacing a non-manager is 29% of the person's annual salary.
- Average cost of replacing a manager is 46% of the person's annual salary.
- Turnover costs an organization with 13,000 employees more than \$27 million per year.
- Replacement costs do not generally vary based on company size, revenue, or public/private status.



Attracting Premier Talent

They will find non-traditional pay structures alluring and meaningful

Value sharing pay structures will respect their entrepreneurial mindset and appeal to their interest in wealth accumulation opps

They will accept the responsibilities and accountability associated with true value creation (i.e., they won't "expect" higher pay without creating results)

They will particularly value pay arrangements that defer taxes and build wealth

Four ideas

1. Equity sharing
2. Phantom equity sharing
3. Tax-free executive benefits
4. Classic deferred compensation

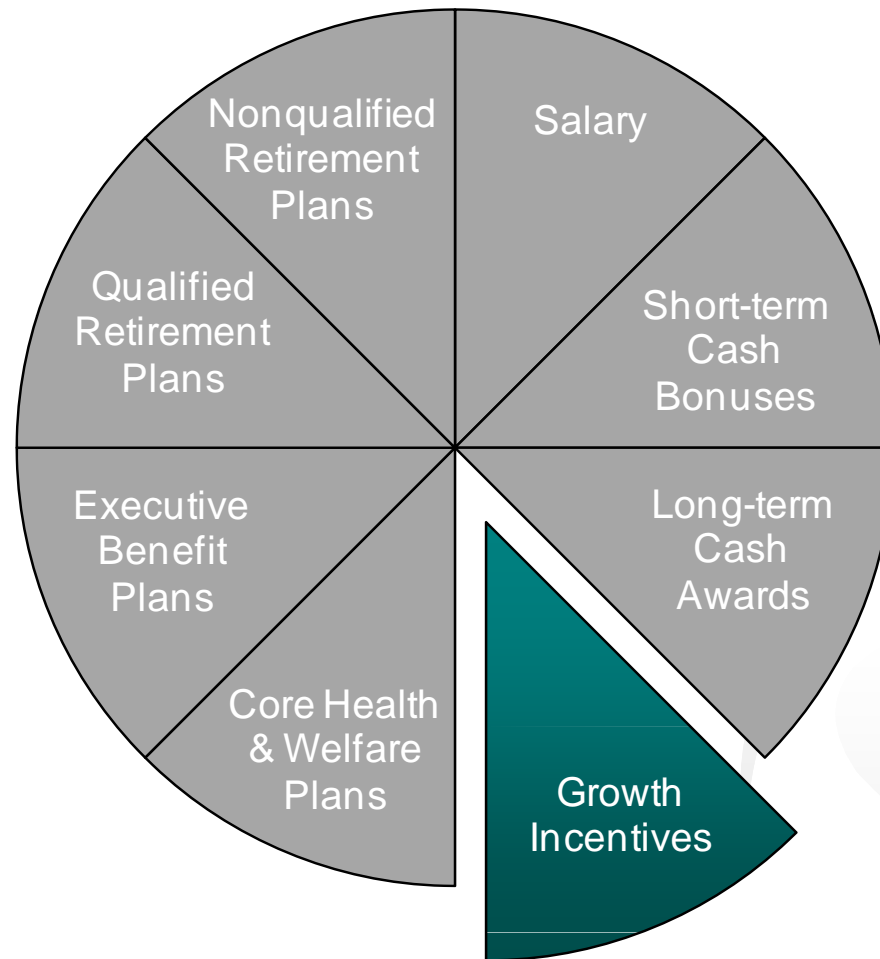


#1 Equity Sharing

An Equity Sharing plan rewards top performers by allowing them to receive or purchase stock at today's price and enjoy preferred tax-savings in the future



Total Compensation Allocation



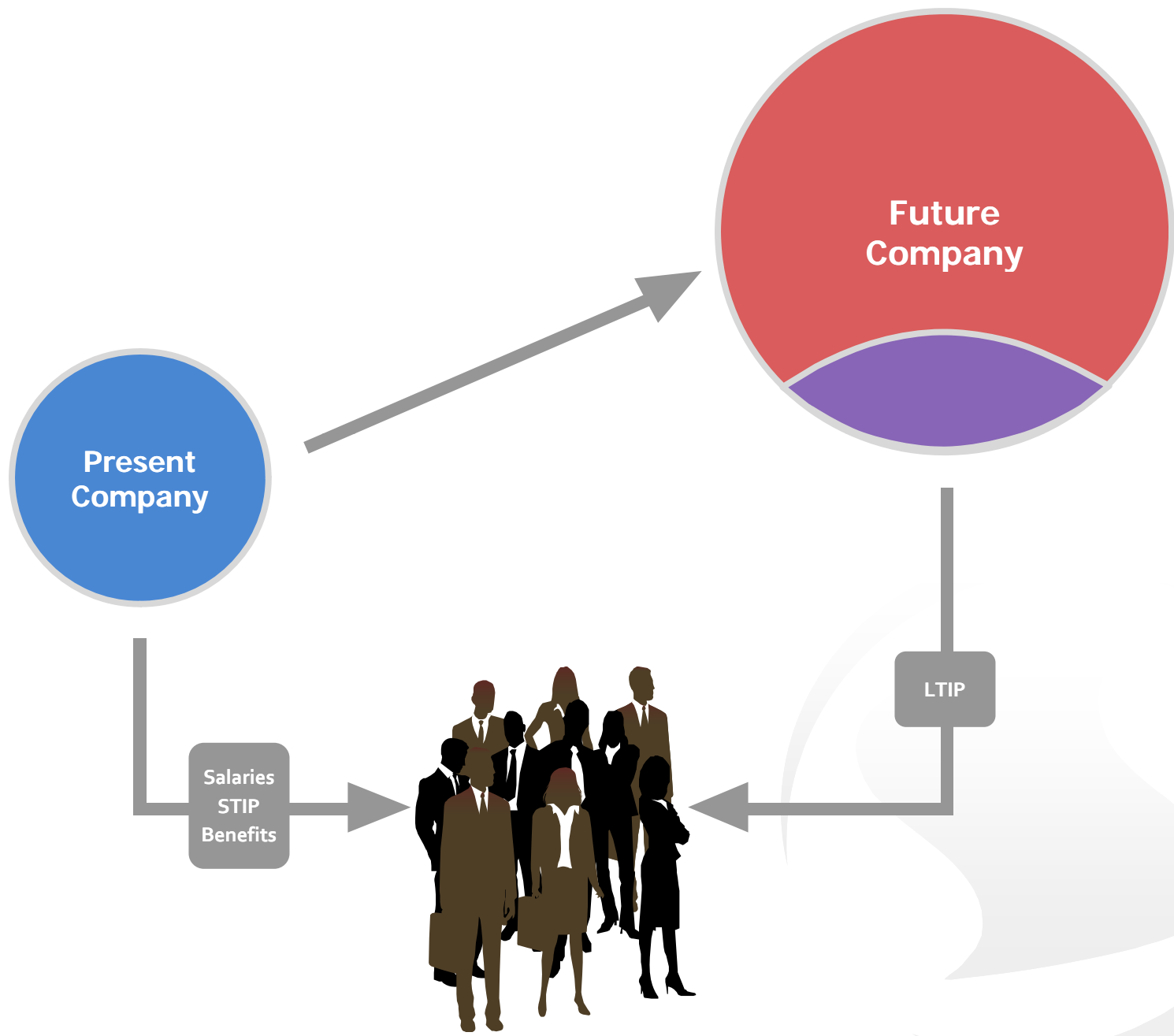
Warning



Two types of equity plans

- Restricted Stock
 - An award of actual stock—subject to a vesting period
- Stock Options
 - The right to purchase stock at a future date, but at today's price





Restricted Stock—Taxes

- Provide an award today, but defer taxes until vesting period is satisfied
- Alternately, the employee may choose* to pay the taxes today at the “lower value”
- Once he has established his basis, he may be eligible for LT capital gains taxation on stock sale

*Optional 83(b) election



Stock Options—Taxes

- No tax when options are awarded
- At time of exercise:
 - With incentive stock options (ISO), no tax when option is exercised
 - With nonqualified options (NSO), ordinary income when option is exercised
- Once exercised, stock held for one year may be eligible for LT capital gains taxation on sale

Stock or Options

- Secure true partnership relationship
- No cash cost to the company
 - May receive cash if options
- Attractive tax results for employee
- More effective form of compensation than “more cash”

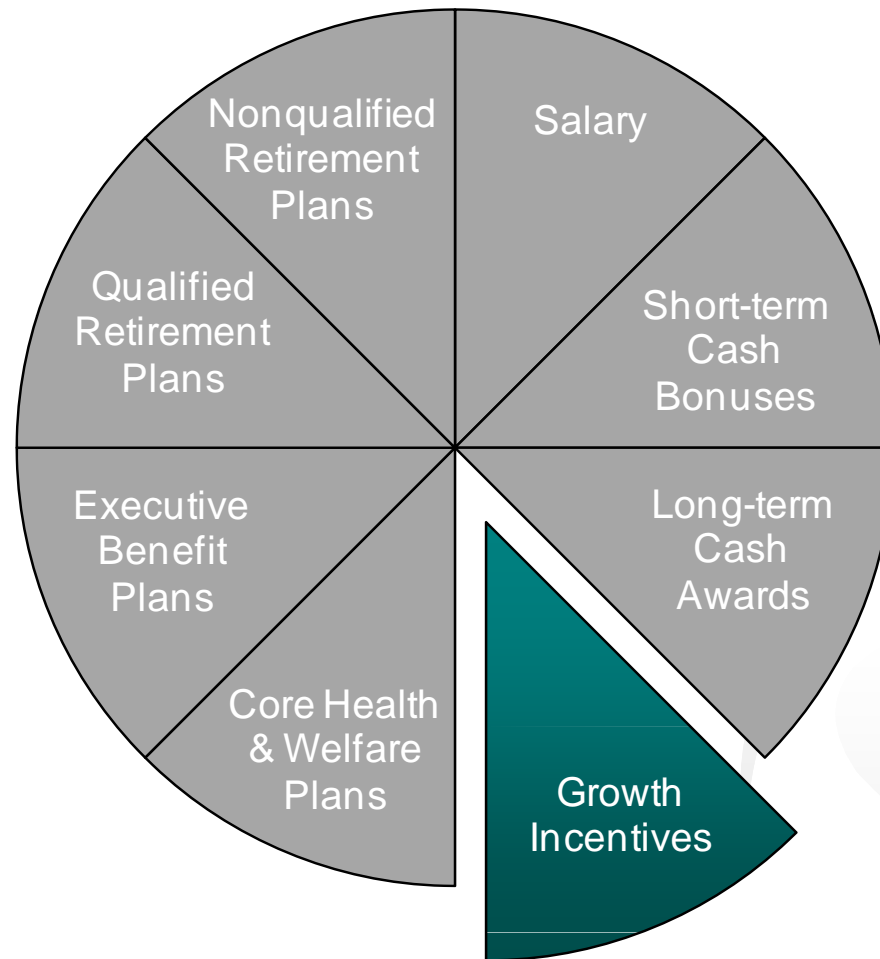


#2 Phantom Stock

- What is it?
- What's the goal?
- Tax Impact



Total Compensation Allocation



What is Phantom Stock?

- A deferred bonus
- Awards made in “units” (like stock or stock options)
- Unit price is tied to a formula (or appraisal) that reflects company value
- Settled in cash (almost always)





Phantom Stock—Taxes

- No tax when units are awarded
- Appreciation not taxed until paid
- Upon redemption, taxed as ordinary income
 - The tax benefit reflects value offered today with taxes deferred to the future



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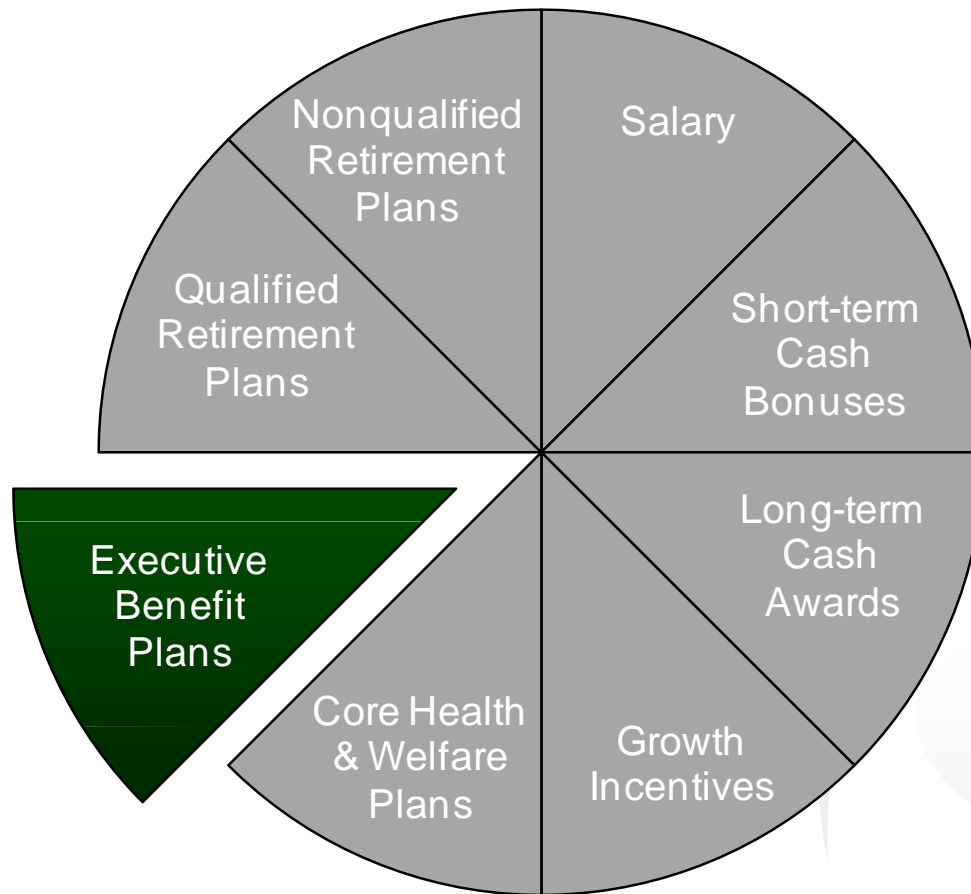


#3 Tax Free Executive Benefits

Executive benefit plans are special programs for key employees that supplement or replace those offered to all rank-and-file employees.



Total Compensation Allocation



Unique Tax Features

- Some EB programs provide the double tax benefit of:
 - Tax-deductibility for the employer
 - No current tax consequence for the employee

Let's look at two examples

Long-term Care Insurance

- Considered A&H insurance (HIPAA)
- Can carve out classes of employees
- Company can deduct 100% of LTC premiums for employees, spouses and parents
- Special “executive benefit” policies can be paid over shorter period than normal
- **No income taxes paid by employee (either on premium or benefits)**

Long-term Disability Insurance

- “Executive Carve-Out”
- Most group LTD plans have significant limitations—definitions, caps, gaps, restrictions, etc.
- Company can provide superior coverage for executives and deduct 100% of premiums
- Rates are discounted
- **No income taxes paid by employee (on premium)**



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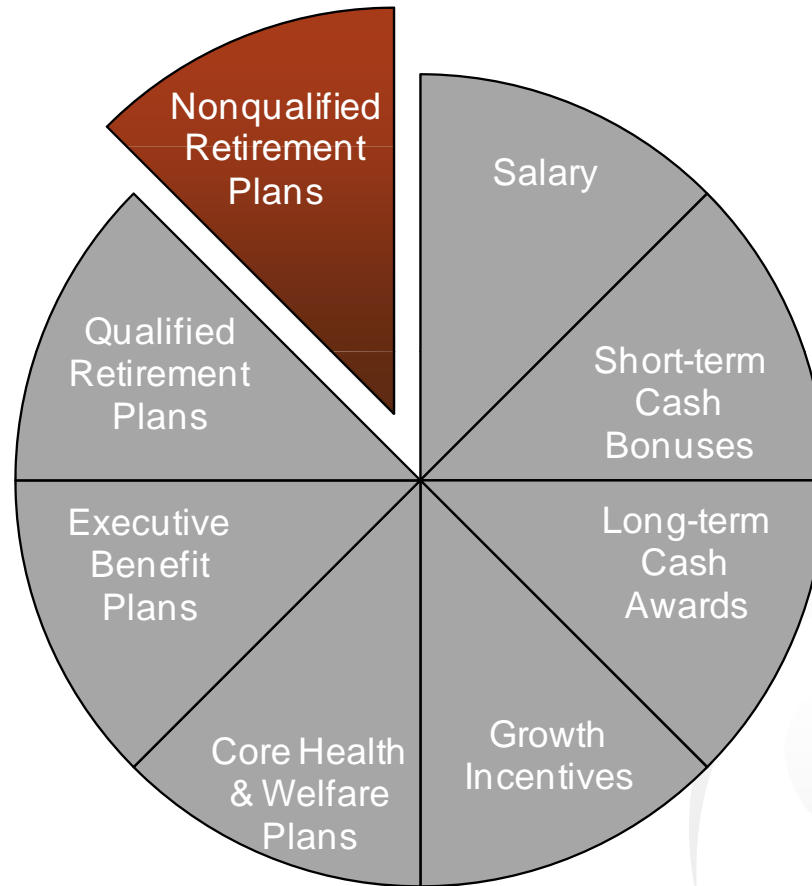


#4 Classic Deferred Compensation

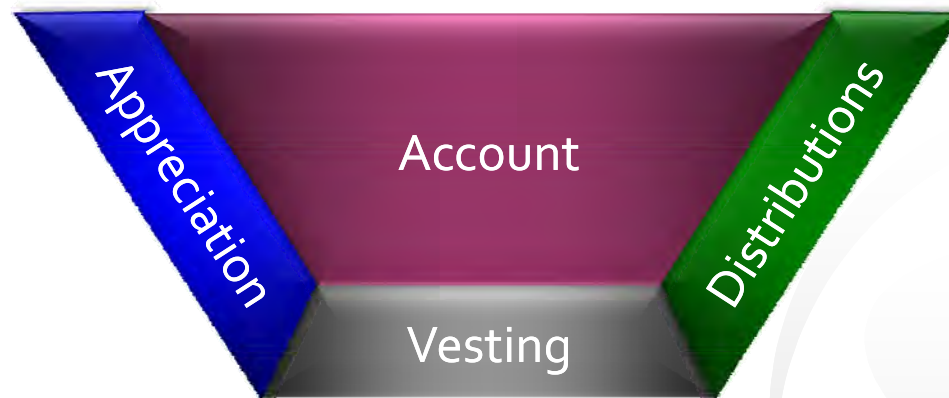
A Deferred Compensation Plan (DCP) is a retirement program intended to provide current tax savings and long-term security for a select group of key employees above and beyond those provided under the company's qualified retirement plans.



Total Compensation Allocation

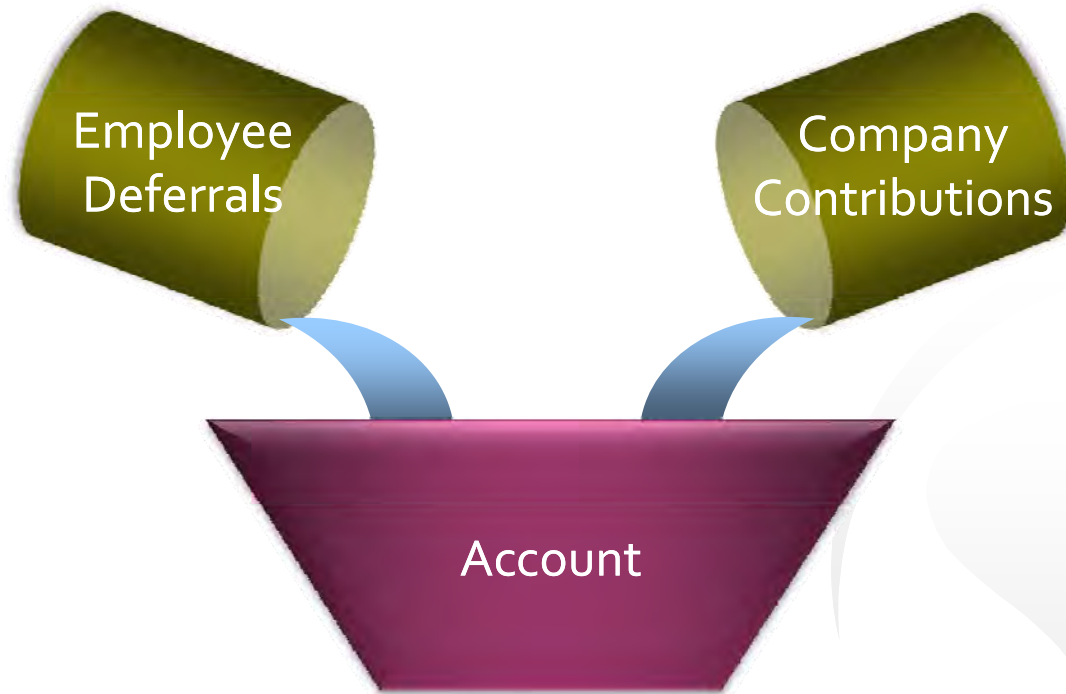


The 4 Basic Components of a Deferred Compensation Plan (DCP)



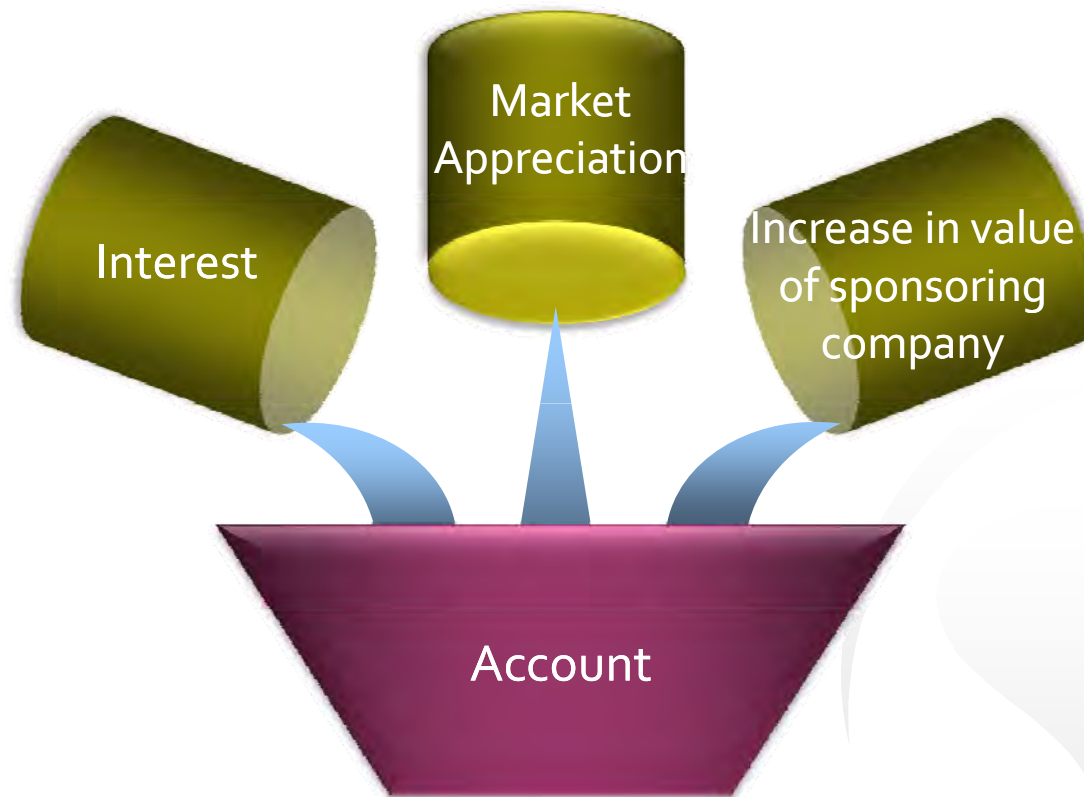
The Account

A liability on the books of the sponsoring company



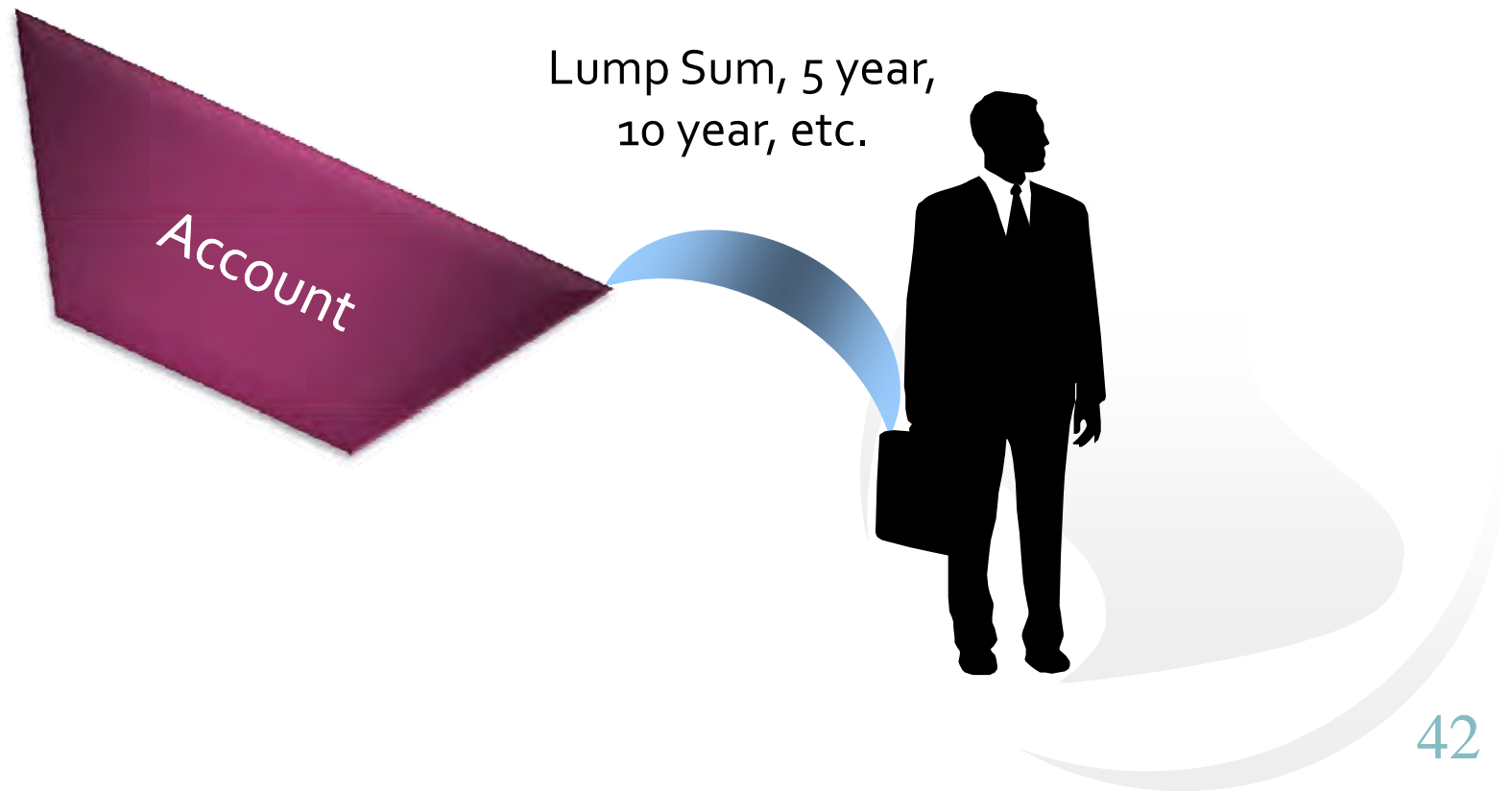
The Appreciation

The gains (or losses) credited to the Account



Distributions

The manner in which the Account is distributed



Plan Type: Executive Deferral Plan

- Executives given option to *voluntarily* remit *pre-tax* deferrals
- May include company contribution (matching, ad hoc, profit sharing, incentive)
- Investment options provided similar to company 401(k) plan
- Participants are fully vested in their own deferrals, partially vested in company's

What about taxes?

- Deferral (income taxes)
 - No income taxes paid on amounts deferred
 - No tax on gains until received (higher compounding)
- Deferral (payroll taxes)
 - Paid now (over wage base)
 - No payroll taxes paid on growth
- Distributions
 - Ordinary taxes on distributions (no payroll taxes)
 - Installment distribution options spread taxes (below marginal rates?) and into new state brackets



Alternative: After-tax brokerage account

- Pay income taxes on earnings today (at highest marginal rates)
- Pay ordinary or capital gains taxes on growth



Let's compare

		DCP			Brokerage Account			Adv/(Disad) of DCP	
		Year	Annual Deposit	Year-end Value	Value Exposed to Max Tax (Dist)	Year	After Tax Comp (to be invested)		Year-End Value
Annual Amount to Defer/Invest	\$ 40,000								
Rate of Return:	6.00%	1	40,000	41,404	22,938	1	21,220	22,046	892
Fed Marginal Tax Rate	39.60%	2	40,000	85,291	47,251	2	21,220	44,950	2,301
State Marginal Tax Rate	5.00%	3	40,000	131,813	73,024	3	21,220	68,746	4,278
Fed Capital Gains Rate	20.00%	4	40,000	181,125	100,343	4	21,220	93,468	6,875
State Capital Gains Rate	5.00%	5	40,000	233,396	129,301	5	21,220	119,153	10,148
Medicare Tax	2.35%	6	40,000	288,803	159,997	6	21,220	145,837	14,160
Medicare Surtax	3.80%	7	40,000	347,535	192,534	7	21,220	173,561	18,974
Investment Account Equity	60.00%	8	40,000	409,791	227,024	8	21,220	202,363	24,661
Tax Rate on Investments	35.12%	9	40,000	475,782	263,583	9	21,220	232,287	31,296
		10	40,000	545,732	302,336	10	21,220	263,375	38,961

Retirement Tax Rates:	
Fed	39.60%
State	5.00%

Equivalent Pre-tax Return to	9.8%
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Use deferral plan to...

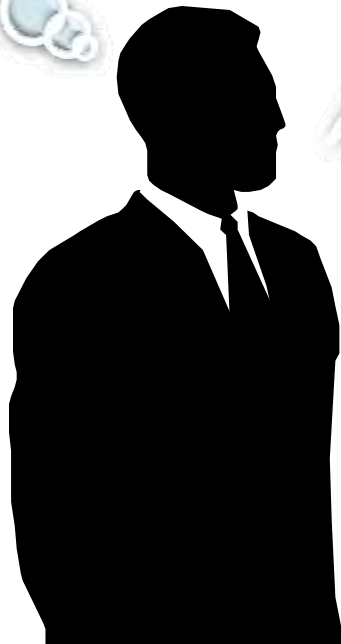
- ...move taxable income below the new top rate (\$400k/\$450k)
- ...lower your MAGI below the threshold for increase in Medicare tax (\$200k/\$250k)
- ...lower your AGI below the threshold for phasing out personal exemptions and itemized deductions (\$250k/300k)



Message to your employee-partners:

Retention: leave
and you'll incur the
taxes all at once

We'll provide a way for you
to reduce today's income
taxes and accumulate
money on a faster basis for
retirement

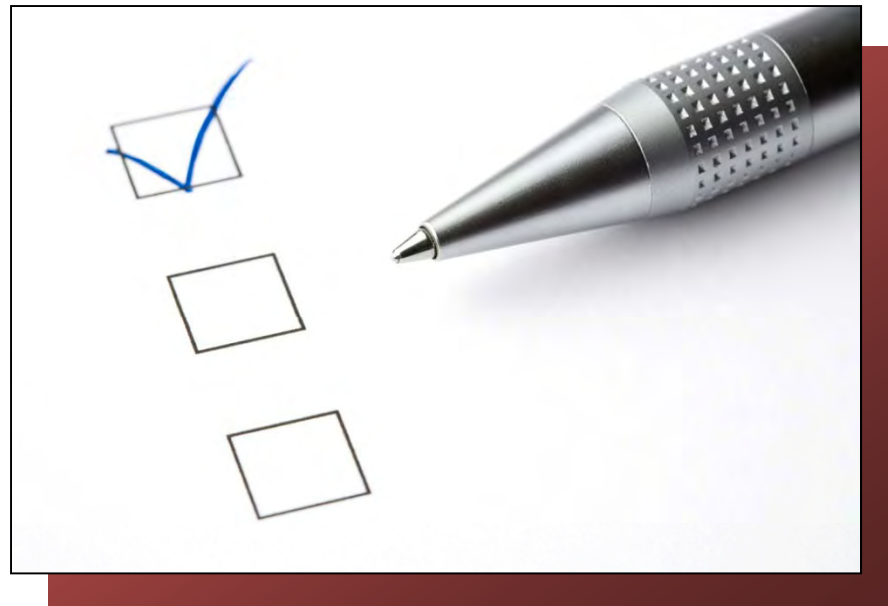


Employer Taxes

- No deduction when amounts are deferred (shareholder taxes may go up for now)
- Trade-off: Larger deduction in the future (deferral plus interest)



Poll



Summary Points

- Create a unique, partnership approach to compensation for your premier talent
 - Enhance your “attractability”
 - Strengthen your “retainability”
- Go “Tax Free” first, then “Tax Deferred”



Tax Leveraged Pay Package

Package A	Component	Package B
\$ 300,000	Salary	\$ 200,000
\$ 100,000	STIP	\$ 50,000
0	LTIP	\$ 75,000
\$ 20,000	Group Health	\$ 20,000
0	Exec Benefits	\$ 25,000
\$ 20,000	QRP	\$ 20,000
0	NQRP	\$ 50,000
\$ 440,000	Total Present Value	\$ 440,000
\$ 400,000	Taxable Amount	\$ 250,000
\$ 20,000	Tax Free Amount	\$ 45,000
\$ 20,000	Tax Deferred Amount	\$ 145,000

John's alternative comp package

Employee Value Statement - Typical

John Ferry @ Target

Cash Needs						
	2012	2013	2014	2015	2016	2017
Annual Salary	\$325,000	\$334,750	\$ 344,793	\$ 355,136	\$ 365,790	\$ 376,764
Bonus	\$ 85,000	\$ 87,550	\$ 90,177	\$ 92,882	\$ 95,668	\$ 98,538
Total Cash Received	\$410,000	\$422,300	\$ 434,969	\$ 448,018	\$ 461,459	\$ 475,302
Security Needs						
Core Benefits	\$ 21,000	\$ 22,260	\$ 23,596	\$ 25,011	\$ 26,512	\$ 28,103
Executive Benefits						
Total Value	\$ 21,000	\$ 22,260	\$ 23,596	\$ 25,011	\$ 26,512	\$ 28,103
Wealth Accumulation						
Long-Term Incentive Plan (SAR)						
Annual Distribution						
Increase in Vested Value						
Remaining Unvested Value						
Total Value (Paid, Vested & Unvested)						
Retirement Plans						
401(k) Company Match	\$ 16,500	\$ 16,995	\$ 17,505	\$ 18,030	\$ 18,571	\$ 19,128
Deferred Comp Match						
Total Value Projection						
Total Cash Received	\$410,000	\$422,300	\$ 434,969	\$ 448,018	\$ 461,459	\$ 475,302
Total Benefits Annual Value	\$ 21,000	\$ 22,260	\$ 23,596	\$ 25,011	\$ 26,512	\$ 28,103
Annual Value of LTIP	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Annual Value of Ret Plan Contribution	\$ 16,500	\$ 16,995	\$ 17,505	\$ 18,030	\$ 18,571	\$ 19,128
Total Annual Value	\$447,500	\$461,555	\$ 476,069	\$ 491,059	\$ 506,542	\$ 522,533
Total Wealth Projection	447,500	\$909,055	\$ 1,385,124	\$ 1,876,184	\$ 2,382,725	\$ 2,905,259

John's alternative comp package

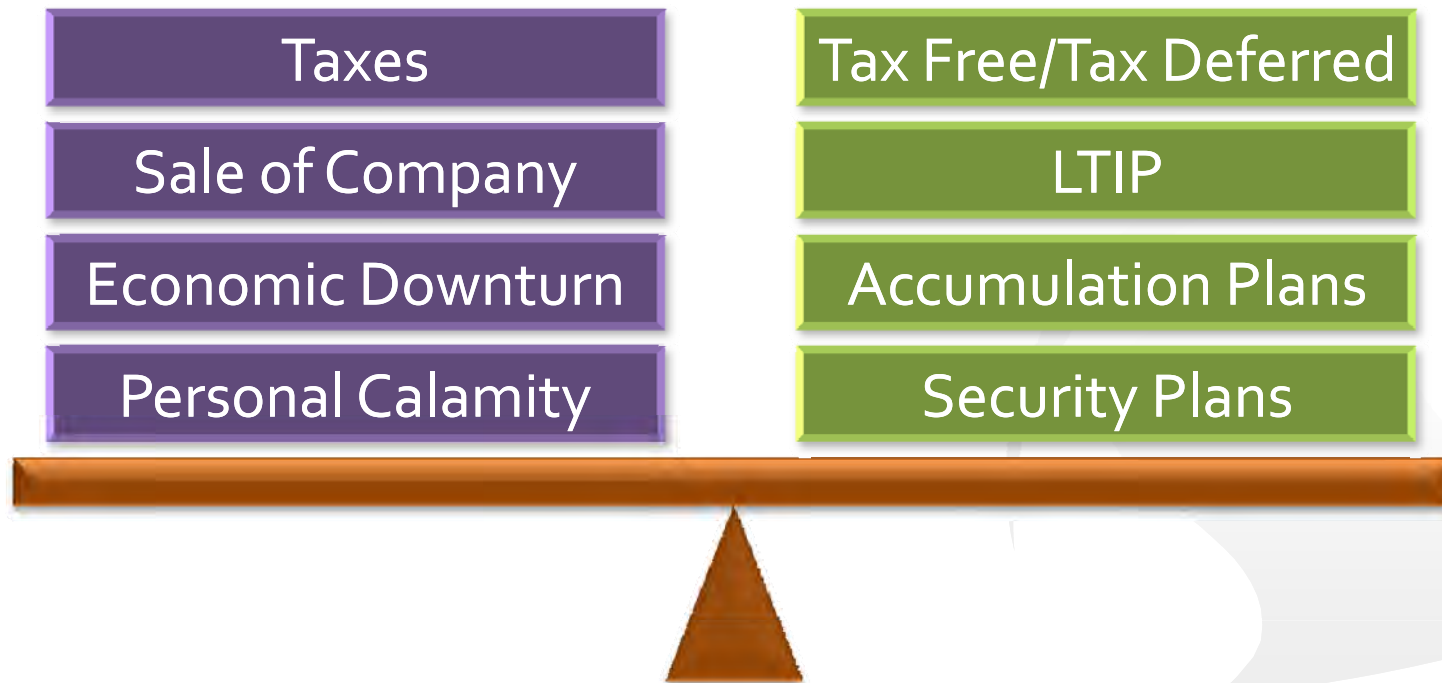
Employee Value Statement - Amplified

John Ferry @ Target

Cash Needs						
	2012	2013	2014	2015	2016	2017
Annual Salary	\$325,000	\$334,750	\$344,793	\$355,136	\$365,790	\$376,764
Bonus	\$85,000	\$87,550	\$90,177	\$92,882	\$95,668	\$98,538
Total Cash Received	\$410,000	\$422,300	\$434,969	\$448,018	\$461,459	\$475,302
Security Needs						
Core Benefits	\$21,000	\$22,260	\$23,596	\$25,011	\$26,512	\$28,103
Executive Benefits	\$18,000	\$18,540	\$19,096	\$19,669	\$20,259	\$20,867
Total Value	\$39,000	\$40,800	\$42,692	\$44,680	\$46,771	\$48,970
Wealth Accumulation						
Long-Term Incentive Plan (SAR)						
Annual Distribution	\$-	\$-	\$-	\$287,767	\$287,159	\$291,978
Increase in Vested Value	\$-	\$-	\$287,767	\$287,159	\$291,978	\$272,602
Remaining Unvested Value		\$81,408	\$256,731	\$257,488	\$259,262	\$266,263
Total Value (Paid, Vested & Unvested)		\$81,408	\$544,498	\$832,414	\$838,399	\$830,843
Retirement Plans						
401(k) Company Match	\$16,500	\$16,995	\$17,505	\$18,030	\$18,571	\$19,128
Deferred Comp Match	\$20,000	\$20,600	\$21,218	\$21,855	\$22,510	\$23,185
Total Value Projection						
Total Cash Received	\$410,000	\$422,300	\$434,969	\$448,018	\$461,459	\$475,302
Total Benefits Annual Value	\$39,000	\$40,800	\$42,692	\$44,680	\$46,771	\$48,970
Annual Value of LTIP	\$-	\$-	\$287,767	\$287,159	\$291,978	\$272,602
Annual Value of Ret Plan Contributions	\$36,500	\$37,595	\$38,723	\$39,885	\$41,081	\$42,314
Total Annual Value	\$485,500	\$500,695	\$804,151	\$819,742	\$841,289	\$839,187
Total Wealth Projection	485,500	\$986,195	\$1,790,346	\$2,610,088	\$3,451,377	\$4,290,564

Optimizing Economic Value

Threats to Employee's Security



Compensation Plans That

Increase Employee Confidence

Build Wealth

Reduce Taxes



Engagement and Productivity

Next Online Seminar:

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To be held on:
Tuesday, March 26th, 2013

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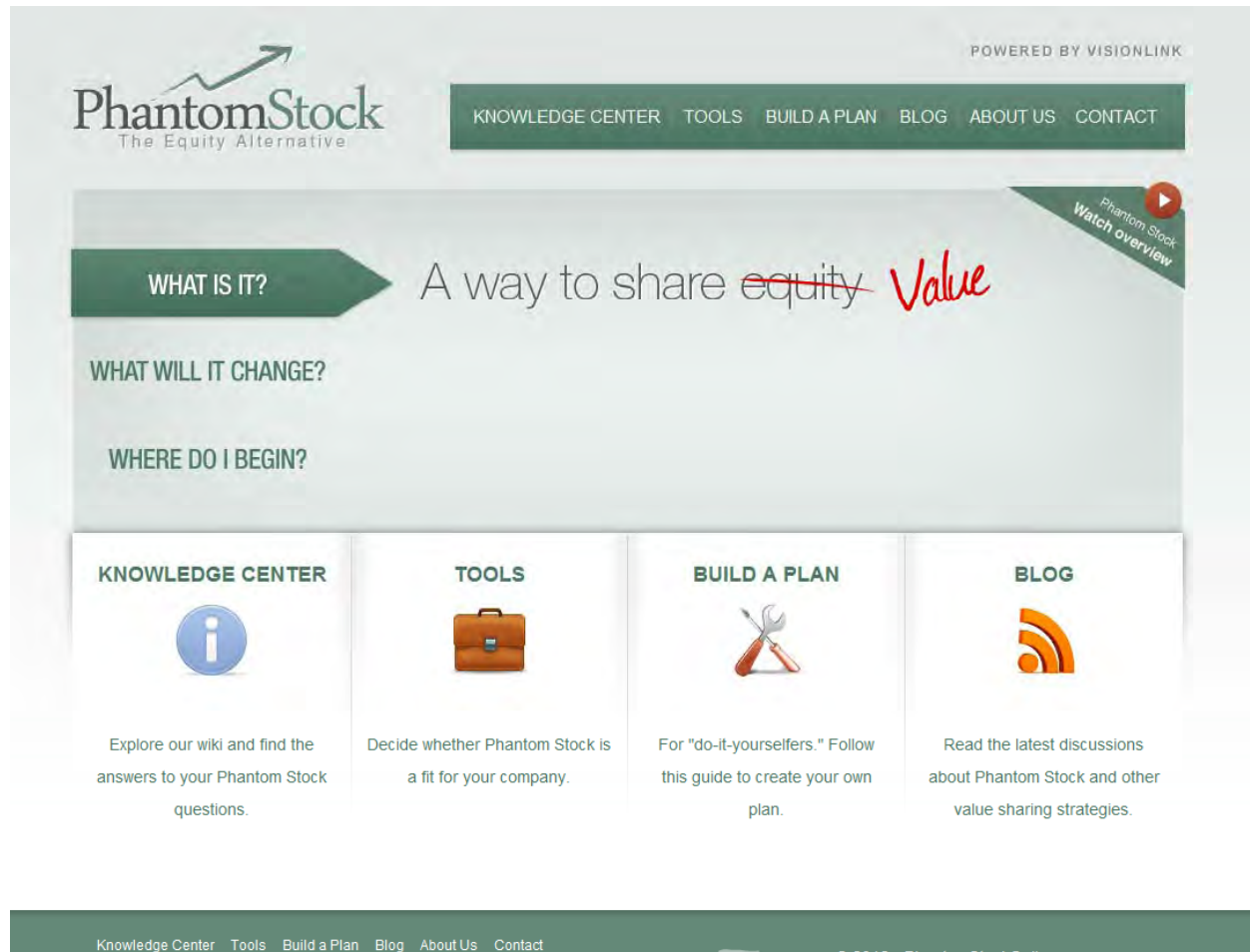
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The screenshot shows the homepage of The VisionLink Advisory Group. At the top left is the logo, and at the top right is a 'Client Login' button. Below the logo is the phone number (888) 703 0080. A navigation bar contains links for Home, About Us, Client Profile, Knowledge Center, Speaking Engagements, Events, Blog, and Contact Us. The main content area features a large image of a mountain peak with a text box on the right asking 'How should I Share Value?' and a 'Learn More' button. Below this are three smaller article teasers: 'WHAT IS PHANTOM STOCK?', 'HOW SHOULD I SHARE VALUE?', and 'HOW DO I END ENTITLEMENTS?'. The 'Events' section lists four dates with descriptions of webinars. There is also a 'Join our webinar invitation list' form with an 'Email Address' field and a 'Go' button. At the bottom, three columns provide advice: 'ASK THE RIGHT QUESTIONS', 'FOLLOW THE RIGHT PROCESS', and 'CHOOSE THE RIGHT COACHES'.

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WHITE PAPER

Phantom Stock: The Ideal Plan for Growing Private Companies



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Q & A

Thank you!

Tom Miller

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