

# Supplemental Executive Retirement Plan (SERP) *Using Life Insurance*



**Agreement**

- 1** Employer enters into an agreement with the Executive for the payment of supplemental retirement income. These benefits will be financed with Employer dollars, and may be subject to a "substantial risk of forfeiture."



**Life Insurance Policy**

**Employer  
Non-Deductible  
Premiums**

**Equity/  
Death Benefit**

- 2** Employer purchases a life insurance policy on the Executive's life, naming itself owner and beneficiary of this policy. The policy provides a death benefit and tax deferred accumulation of cash values.



**Employer**

**Employer  
Tax-Deductible  
SERP  
Compensation**



**Insured/Executive**

- 4** At retirement, Executive receives the SERP compensation from the Employer.



**Heirs**

- 3** In the event of Executive's death, heirs will either receive annual income or a lump sum payment from the Employer.

## What Is Being Accomplished?

### For the Employer

- At retirement, Employer receives federal income tax deduction for retirement benefits paid to the Executive.
- Promotes Executive's loyalty.
- Tax deferred growth on accumulation of cash value that may be used to pay retirement benefits to the Executive.

### For the Executive

- Accumulate supplemental retirement income in excess of the qualified plan limits.

### For the Heirs

- Provide death benefits if Executive dies.

# Supplemental Executive Retirement Plan (SERP)

## *The Situation*

It is a well known fact that the most important assets of any business are its key people. Consequently, it is very important for business owners to find ways of attracting and retaining key executives. Coincidentally, this often occurs at a time when executives are experiencing difficulty in planning for their own retirement. Today's executives are having trouble accumulating retirement dollars because most savings programs are funded with after-tax dollars, and as a result of the "reverse discrimination" that highly compensated executives experience under qualified plan limits. Also, any gains on these investments are currently taxed, thereby reducing the net yield. However, there is a strategy for this difficult situation.

## *The Strategy*

The Employer enters into a Supplemental Executive Retirement Plan (SERP) with its key executives. Through this arrangement, the Employer agrees to provide supplemental retirement income to selected executives and their families in return for the attainment of agreed-upon objectives. Since these benefits are either a mere promise to pay, or are subject to a "substantial risk of forfeiture," they are not currently taxable to the key executives. However, when this deferred compensation is distributed or is no longer subject to a substantial risk of forfeiture, it becomes tax-deductible to the Employer and reportable as income to the executives or their heirs.

## *How It Works*

The Employer purchases a life insurance policy on the Executive's life. In accordance with the agreement, the Employer retains all ownership rights in the policy and names itself beneficiary. Generally, the policy creates an income tax-free death benefit\* and over time a

tax-deferred accumulation of cash values for the Employer. At retirement, the Executive begins receiving the agreed-upon supplemental deferred compensation from the Employer. In the event of the Executive's death, the Employer can use the death benefit to pay the Executive's heirs either annual income or a lump sum settlement. By properly structuring a SERP and the policy, the Employer and the Executive will obtain the following advantages:

## *Employer Advantages*

- Plan has minimal ERISA requirements, and can provide selected employees with supplemental benefits.
- The Employer controls the plan, owns the policy and carries the cash value as an asset on its balance sheet.
- The Employer's cash value accumulates within the insurance policy on a tax-deferred basis.
- Plan benefits are paid with tax-deductible dollars.
- The policy can be structured to allow for Employer cost recovery.

## *Executive Advantages*

- The plan can be custom designed to meet the Executive's individual needs.
- Retirement income is accumulated without current taxation to the Executive.
- The plan, through the policy's death benefit, can be self-completing in the event of the Executive's death.
- The Executive avoids "reverse discrimination" associated with qualified retirement plans.

\* Proceeds from a life insurance policy paid because of the death of the insured are generally excludable from the beneficiary's gross income for federal income tax purposes. IRC Sec. 101(a)(1).



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# Supplemental Executive Retirement Plan (SERP)

## *Vital Information*

(To generate a personalized life insurance policy illustration)

Executive \_\_\_\_\_ Date of Birth \_\_\_\_\_

Spouse \_\_\_\_\_ Date of Birth \_\_\_\_\_

Risk Status: Insured S \_\_\_\_\_ NS \_\_\_\_\_ Spouse S \_\_\_\_\_ NS \_\_\_\_\_

Executive's Total Compensation \$ \_\_\_\_\_

Federal Tax Bracket \_\_\_\_\_ % State Tax Bracket \_\_\_\_\_ %

Retirement: Age \_\_\_\_\_ Annual Income Goal \$ \_\_\_\_\_

Current Sources of Retirement Income:

(A) Qualified Plans \$ \_\_\_\_\_

(B) Non-Qualified Plans \$ \_\_\_\_\_

(C) Investments \$ \_\_\_\_\_

Estimated Annual Deferred Compensation \$ \_\_\_\_\_ For \_\_\_\_\_ Years

Employer Name \_\_\_\_\_

Corporate Status C \_\_\_\_\_ S \_\_\_\_\_ Partnership \_\_\_\_\_ LLC \_\_\_\_\_

Federal Tax Bracket \_\_\_\_\_ % State Tax Bracket \_\_\_\_\_ %

Employer Annual Premium Commitment \$ \_\_\_\_\_

Employer Life Insurance Need \$ \_\_\_\_\_

## **ADDITIONAL NOTES**

Producer Name: \_\_\_\_\_ Date: \_\_\_\_\_

In accordance with existing and pending state insurable interest laws the client may not have an insurable interest in the insured unless certain conditions are met. Failure to satisfy state insurable interest requirements may result in disqualification of the policy as "life insurance" under IRC section 7702, and also may among other things void the policy. Furthermore, even assuming compliance with state laws, under pending federal tax legislation, the death benefits of the life insurance policy used in this design may not be income tax free under IRC section 101(a)(1) unless certain conditions are met. These conditions, for both the state and federal level, may include, but not be limited to, the insureds providing written consent to be insured and the insured falling within a certain employee classification or group. Clients proposing this design must consult with legal counsel to determine whether these conditions apply to their situation and, if so, whether these conditions are met.



Pacific Life Insurance Company  
700 Newport Center Drive, Newport Beach, California 92660

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