EQUITABLE

Planning perspective

The BATL Plan®

Bonus and Tax Loan (BATL)

It can be argued that a business's most valuable assets are its employees, the talented people who are committed to making "it" happen — day in and day out.

Attracting, retaining and rewarding key people is instrumental to the success of any business.

Since key employee benefits are provided by most competitive businesses, many talented and highly compensated executives are searching for other ways to defer current income in favor of augmenting funds available at retirement.

There are several employee benefits common to most businesses:

- Social Security
- Health and medical insurance
- Life and disability insurance
- Traditional qualified retirement plans, such as 401(k) or SIMPLE IRAs

Lost deferral opportunity

The Section 401(k) plan has become a popular plan to set aside income for retirement, but government regulations limit maximum annual contributions for highly compensated employees.

As of 2024, employee contributions to 401(k) plans are limited to $23,000 ($30,500 for ages 50 and older) even if the executive wants, can and needs to defer more. Contributions may be limited even further if the rank and file employees are not making deferrals.

The restrictions placed on traditional 401(k) plans have contributed to a form of reverse discrimination.

Although they allow an average employee an opportunity to protect a significant portion of their current income, they are significantly inadequate in protecting the compensation of key employees, including the business owners. In effect, a significant gap exists between the portion of income a highly compensated employee can protect versus an average employee. The ratio can be as high as 1 to 3, which means the highly compensated employee ends up protecting ⅔ less compensation than the average employee.

How does reverse discrimination affect key employees' retirement incomes?

Consider the savings disparity between an employee earning $50,000 a year (Mr. Smith) and a key employee earning $350,000 (Mr. Jones). Here is what they could both save in a 401(k) plan (we will assume both are age 45):

	Smith	Jones
Total compensation	$50,000	$350,000
401(k) deferral opportunity (assume $23,000 maximum contribution)	46.0%*	6.57%*
Company match $.25 on the dollar, up to 3% of salary	3.0%	1.64%
Potential deferral opportunity (with match)	49.0%	8.21%

* Limited by a $23,000 maximum contribution limit in 2024. These amounts could be limited further depending on nondiscrimination rules. This comparison does not take into consideration the possibility of the executive making after-tax contributions to the 401(k) plan.

Employers with traditional pension plans in place have already taken a good step in showing they value their employees' commitment. Unfortunately, this may not be enough to help retain key people. A retirement income gap could drive some of the best talent to take positions with competitors offering retirement programs that better meet their needs.

The result: Employers suddenly find that the financial success they have worked so hard to achieve is not so secure with the loss of experienced staff members.

Methods for overcoming 401(k) deferral limits

Highly compensated executives whose retirement savings goals have been affected by the 401(k) plan deferral limits have generally had two ways to try to overcome this problem. First, executives with the discipline to do so may accumulate the net after-tax amounts they would have deferred in personally held investments. A personal retirement savings program is far more effective than spending the net after-tax income, but it does have its drawbacks:

- Since the compensation received is currently taxable income, there is less money to invest for retirement savings.
- Taxes on earnings will further erode retirement savings.
- Unlike qualified plans, the money saved for retirement can be reached by the executive's personal creditors.

Other executives — with employers who are willing to participate — will defer the income on a nonqualified basis. This can also be an effective strategy, but it too has some disadvantages:

- The executives' deferral accounts are subject to the claims of the employer's creditors as well as their own. Their funds could be lost if the employer runs into financial problems.
- Rules under IRC §409A place stringent requirements for in-service withdrawals, making it difficult for participants to access those funds in case of a financial "emergency."
- There are costs involved for the employer if the full amount of the deferrals are to be accumulated for the executives' benefit,[1] since no compensation deductions are allowed until the compensation is paid or otherwise made available to the executive.

1 Fees charged by plan administrators are also typically borne by the employer. However, these fees are usually modest in nature.

An innovative alternative: The BATL Plan®

The BATL Plan® is an arrangement between the employer and the executive that involves a combination loan and bonus. The employee purchases a cash value life insurance policy and pays the premiums with bonuses from the employer. The bonuses themselves will be subject to income tax, but the employer loans the employee the funds to cover the additional tax amounts. As a result, the entire bonus can be used to pay premiums, providing a way to maximize the tax-deferred cash value accumulation in the life insurance policy. The policy cash values will be used to supplement retirement income.

Advantages to the employer

- Selective: The employer can pick and choose the executives
- Ties key executives to the business
- Majority of cost is tax-deductible
- Control of the plan rests with the employer
- No IRS approval needed
- Easy to establish: Minimal setup and administrative costs

Other considerations for the employer

- Insurance policy is portable for employee; as such, the "golden handcuffs" on employee are not as strong as with other nonqualified plans
- Publicly traded companies cannot participate due to Sarbanes-Oxley Act

Advantages to the employee

- Supplemental retirement benefits and death benefit protection
- Income tax-free survivor benefits[2]
- Potential tax-deferred cash value growth
- Possible access to cash surrender value over time (subject to agreement) and portable
- Generally protected from creditors[3]
- Potential for plan to become self-completing in the event of disability[4]

Other considerations for the employee

- Even though income taxes on the bonus are covered with loans from the employer, the employee at some point may be pushed into a higher tax bracket. This can create a taxable consequence for the employee who is not covered by the loan.
- Must carefully structure any income disbursements from the policy to avoid unintended tax consequences.

2 IRC 101(a).

3 State law controls creditor protection.

4 Requires purchase of disability rider.

Case study

To see how the BATL Plan® may help a highly compensated executive, let's use "Mr. Jones" from the example. Using the BATL Plan®, a bridge over the deferral gap can be created.

In a typical bonus arrangement, the employee would have to pay the taxes on the bonus from their own income, or net the taxes and pay a lower premium for a policy with a lower amount of death benefit protection. With the BATL Plan®, the employee can apply the full bonus to the premiums without having to use any personal funds to pay taxes.

Meet Mr. Jones

Do you have clients like Mr. Jones with a need to save more for retirement?

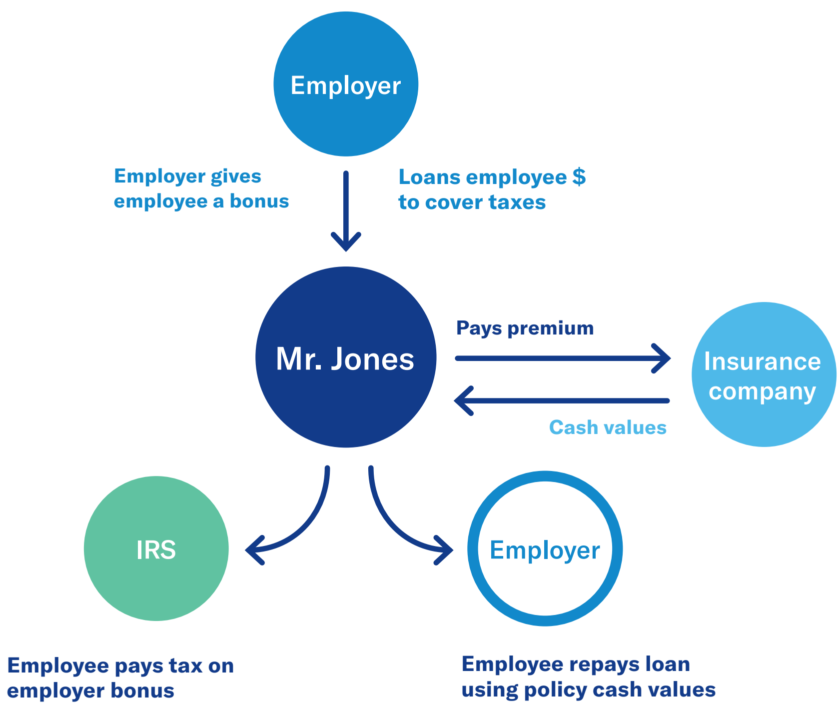
- Nonsmoker in good health
- Highly compensated individual in a 32% marginal income tax bracket
- Each year, he will receive an annual bonus compensation of $50,000, which would result in an additional $16,000 of income taxes

Over the first 7 years

A series of seven annual bonuses are planned in order to take advantage of maximum cash value accumulation potential under the "7-Pay Test" required by Internal Revenue Section 7702A. For our case, we will assume interest on the loan is accrued. See the graphic below for the hypothetical design.

- The full amount of each bonus will be applied to a life insurance policy.
- The employer will lend the employee the tax amount associated with each bonus for 7 years.
- Any interest due on prior years' loans and any future interest after the first 7 years can be paid by the employee out of pocket.
- Or, if the employer is willing, the employee can accrue future interest and add it to the loan balance.[5]

The BATL Plan®



5 The loan interest rate charged by the employer should be at least equal to the Applicable Federal Rate (AFR) in effect at the time of the loan. Interest-free or below-market (i.e., AFR) interest rate loans are subject to §7872, which imposes taxes on imputed "forgone interest."

Prior to retirement

- The employee receives a bonus of $50,000 each year to be paid into the employee's life insurance policy. The cumulative total will be $350,000 in bonus compensation.
- The employee could borrow over $112,000 over the course of the plan during their working years to help pay their annual taxes for the bonuses, and another $106,000 in accrued loan interest, based on a 4% loan interest rate.

Note: This case is only intended to help demonstrate the planning concept discussed and not to promote any specific product. To determine how this approach might work for you, individual illustrations should be prepared or requested for your review.

At retirement

- The employee works for 20 years and retires at 66. By then he can start taking out an income stream from his life insurance policy that is enough to make annual loan repayments to his employer. Anything left over can be used as supplemental income for retirement. The policy values from the life insurance policy could be used as the main source to repay the employer for all the loans and accrued interest that helped to cover the employee's taxes during his employment.

This is only an example of a possible use of the BATL Plan®. To determine how this approach might work for you, individual illustrations should be prepared or requested for your review.

The BATL Plan® helps to bridge the retirement income shortfall, and over the life of the plan, there is a low cumulative net after-tax cost to the employer for providing this benefit.

The BATL Plan® can be an effective way to reward key people and tie them to the employer in a cost-efficient manner. For further information or to see how this strategy may fit your specific circumstances, contact your financial professional.

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