



Nationwide[®]
is on your side

Accounting: nonqualified deferred compensation plans and financing

Brought to you by the
Advanced Consulting Group of Nationwide[®]

Nationwide, the Nationwide N and Eagle, Nationwide is on your side and other marks displayed in this presentation are service marks of Nationwide Mutual Insurance Company or its affiliates, unless otherwise disclosed. © 2016 Nationwide

Some things you need to know

This presentation is for educational purposes only and is not intended to be a solicitation or sale of a specific product or service.

The general information in this presentation is not intended to be nor should be treated as tax, legal, accounting or other professional advice. Additional facts and circumstances may exist that would impact the tax treatment of a specific transaction. Taxpayers should seek advice from an independent tax advisor before acting on any information presented.

Federal tax laws are complex and subject to change. The information contained herein is not intended to be, and should not be construed to be, tax or legal advice. Neither Nationwide nor its representatives give legal or tax advice. Consult with your attorney or tax advisor for answers to specific questions.

The Nationwide Group Retirement Series includes unregistered group fixed and variable annuities and trust programs. The unregistered group fixed and variable annuities are issued by Nationwide Life Insurance Company. Trust programs and trust services are offered by Nationwide Trust Company, FSB a division of Nationwide Bank®. Nationwide Investment Services Corporation, member FINRA.

- Not a deposit • Not FDIC or NCUSIF insured • Not guaranteed by the institution
- Not insured by any federal government agency • May lose value

Agenda

- Introduction
- Financial statements
 - Balance sheet
 - Income statement
- Sample journal entries
 - Defined contribution plan accounting
 - Defined benefit plan accounting
 - Deferred tax asset
 - When benefits are paid
- Financing methods
 - Corporate-owned life insurance (COLI)
 - Corporate-owned taxable investments



Introduction

This presentation will cover sample accounting entries for nonqualified deferred compensation (NQDC) plans, corporate-owned life insurance (COLI) and corporate-owned taxable investments that are purchased to informally fund a NQDC plan.

Please consult with your accounting or tax advisor for advice that is specific to your situation.

Financial statements

- Qualified plans
 - No effect on employer's balance sheet
 - Contributions to the plan are an expense
- Nonqualified deferred compensation plans
 - Assets (COLI / taxable asset) and plan liabilities shown separately on employer's balance sheet
 - Increases / decreases in asset and plan liability values are reflected on employer's income statement and balance sheet
 - Gains/losses of investments
 - Additional amounts credited and contributed
 - Distributions and withdrawals
 - Death benefits if COLI is used

Balance sheet

- The NQDC plan
 - *Employees defer \$100,000; the employer's tax bracket is 40%; and the plan's rate of return is 8%*
 - *An employee terminates and is paid his account balance of \$5,500 in the same year*

NQDC plan liability account	
Beginning of year balance	\$0
Deferred amounts	\$100,000
Earnings	\$8,000
Distributions	(\$5,500)
Plan liability account	\$102,500

Balance sheet

- NQDC plan

Deferred tax asset*	
Opening balance	\$0
Decrease due to distribution	(\$2,200)
Increase due to increase in liability	\$43,200
Ending balance	\$41,000

**The Cash Account would decrease due to taxes paid on amounts deferred*

Balance sheet

- COLI

Example: Employees defer \$100,000 and employer uses that to pay a premium; the employer's tax bracket is 40%; and the net rate of return in the COLI is 5%

COLI asset account	
Beginning of year CSV	\$0
Increase in CSV (premium + earnings)	\$105,000
COLI balance	\$105,000

Balance sheet

- Summary

Net effect on balance sheet	
NQDC plan liability	(\$108,000)
COLI	\$105,000
Net effect of NQDC plan and COLI	(\$3,000)

Income statement (P&L)

- The NQDC plan

Example: Employees defer \$100,000; the employer's tax bracket is 40%; and the rate of return in the plan is 8%

	Pre-tax
Benefit / compensation expense	\$100,000
End-of-year deferred compensation expense	(\$108,000)
Net impact on current earnings	(\$8,000)

Income statement (P&L)

- Corporate-owned life insurance (COLI)

Example: Employees defer \$100,000 and employer uses that to pay a premium; the employer's tax bracket is 40%; and the net rate of return in the COLI is 5%

	Pre-tax
COLI premium	(\$100,000)
End-of-year CSV increase	\$105,000
Gain / (loss) for the period	\$5,000

Income statement (P&L)

- Summary

Net effect on income statement	Pre-tax
NQDC plan impact on earnings	(\$8,000)
COLI impact on earnings	\$5,000
Net effect of NQDC plan and COLI	(\$3,000)

SAMPLE JOURNAL ENTRIES



Defined contribution plan accounting

- When an employee defers compensation to a NQDC plan
 - The employer sets up a benefit liability account and credits employee deferrals to it
 - Adjustments to the benefit liability account for gains/losses are made periodically
 - The same accounting entries are made for any company contributions to the plan

	DR	CR
Benefit/compensation expense (P&L)	XX	
Benefit liability (balance sheet)		XX

Gains and losses in participants' accounts

- Periodic gains

	DR	CR
Benefit/compensation expense (P&L)	XX	
Benefit liability (Balance sheet)		XX

- Periodic losses

	DR	CR
Benefit liability (Balance sheet)	XX	
Benefit/compensation expense (P&L)		XX

Defined benefit plan accounting

- The annual accrued liability is added to the liability account
 - The annual accrued liability amount is considered a deferral of compensation under Code section 409A
- There usually are no decreases in the benefit liability account until benefit payments begin

	DR	CR
Benefit/compensation expense (P&L)	XX	
Benefit liability (Balance sheet)		XX



Deferred tax asset

- The employer cannot take a deduction for compensation when it is deferred
- The total amount of benefit payments will be deductible when paid to participants
- To account for the “prepayment” of tax (or the delay in taking a deduction), C corporations will book a deferred tax asset
 - Employers that are pass-through entities (e.g., partnerships, S corporations and most LLCs) will not account for this

	DR	CR
Deferred tax asset (Balance sheet)	XX	
Income tax payable (Balance sheet)		XX



When benefits are paid

- Decrease the benefit liability account and cash
- Reverse the deferred tax asset entry made when the liability was credited
- If earnings/losses continue to be credited to the participant's account, the employer will also have to continue to account for those during the payout phase

	DR	CR
Benefit liability (Balance sheet)	XX	
Cash (Balance sheet)		XX

	DR	CR
Income tax payable (Balance sheet)	XX	
Deferred tax asset (Balance sheet)		XX

FINANCING METHODS



Corporate-owned life insurance

- FASB ASC 325-30 (formerly Technical Bulletin No. 85-4) *Accounting for Purchases of Life Insurance* governs the accounting of cash value life insurance
- COLI is often purchased with the employees' salary/bonus deferrals that would otherwise have been paid to them in cash
- The difference between premiums paid in a year and the increase (or decrease) in cash surrender value is a direct charge or credit to the company's earnings
 - *Example: On January 1, company Y paid a premium of \$100,000. On December 31, the cash surrender value is \$107,000. Company Y will have a credit to earnings of \$7,000 for the year*

Corporate-owned life insurance

- Accounting for premium payments
 - Premium payments are not a deductible expense

	DR	CR
COLI expense (P&L)	XX	
Cash (Balance sheet)		XX

- Accounting for the cash surrender value
 - The cash surrender value (CSV) is an asset of the company

	DR	CR
COLI asset – CSV (Balance sheet)	XX	
COLI expense (P&L)*		XX

**This is the difference between the premiums paid and the CSV*

Corporate-owned life insurance

- Accounting for COLI gains and losses

When there is a gain	DR	CR
COLI asset – CSV (Balance sheet)	XX	
COLI premium expense (P&L)		XX
COLI gain/other income (P&L)		XX

When there is a loss	DR	CR
COLI asset – CSV (Balance sheet)	XX	
COLI loss (P&L)	XX	
COLI premium expense (P&L)		XX

Corporate-owned life insurance

- Accounting for withdrawals and loans from COLI

- Withdrawals

	DR	CR
Cash (Balance sheet)	XX	
COLI asset – CSV (Balance sheet)		XX

- Loans

	DR	CR
Cash (Balance sheet)	XX	
COLI loan account (Balance sheet)		XX

COLI death benefits

- When an insured employee dies, the cash surrender value of that policy is taken off the company's books
- Usually, the net amount at risk is a gain to the company
- The total death benefit will be income-tax free*

	DR	CR
Cash (Balance sheet)	XX	
COLI asset – CSV (Balance sheet)		XX
Gain/loss on death (P&L)		XX

**Provided the requirements of Code Sec. 101(j) are met (disclosure and consent).*

Corporate-owned taxable investments

- Governed by ASC 320-10 (Formerly FASB Statement 115)
 - Available for sale securities are accounted for at fair value (“mark to market”)
- Accounting for the purchase of taxable investments

	DR	CR
Taxable asset (Balance sheet)	XX	
Cash (Balance sheet)		XX



Corporate-owned taxable investments

- Accounting for realized gains/losses
 - Dividends and capital gains distributions that are reinvested

When there is a gain	DR	CR
Taxable asset (Balance sheet)	XX	
Other income (P&L)		XX

- Realized gains are taxable to the company

	DR	CR
Tax expense (P&L)	XX	
Cash (Balance sheet)		XX

Corporate-owned taxable investments

- Accounting for unrealized gains/losses
 - These are gains/losses from a change in the value of the asset that has not been settled yet (a change in the NAV of a mutual fund, for example)
- Unrealized gains/losses are credited to a special shareholder equity account on the balance sheet, net of taxes, which are credited to a deferred tax liability account

Corporate-owned taxable investments

- Unrealized gains

	DR	CR
Taxable asset (Balance sheet)	XX	
Special income (P&L)		XX

- Deferred taxes

	DR	CR
Special income (P&L)	XX	
Capitalized deferred taxes (Balance sheet)		XX

QUESTIONS?



Here when you need us

National Sales Desk: 1-800-321-6064
Nationwide Financial Network[®]: 1-877-223-0795
Brokerage General Agents (BGAs): 1-888-767-7373

Option 9, extension:677-6500