Tax Pass Through Entities:
Law, Accounting and Real Estate Brokerage Firms

Presented By:

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Executive Benefit Issues

- Employer Objectives
  - Recruit, Retain, Reward, Retire
  - Benefit equalization across organization – “Restoration” Plans

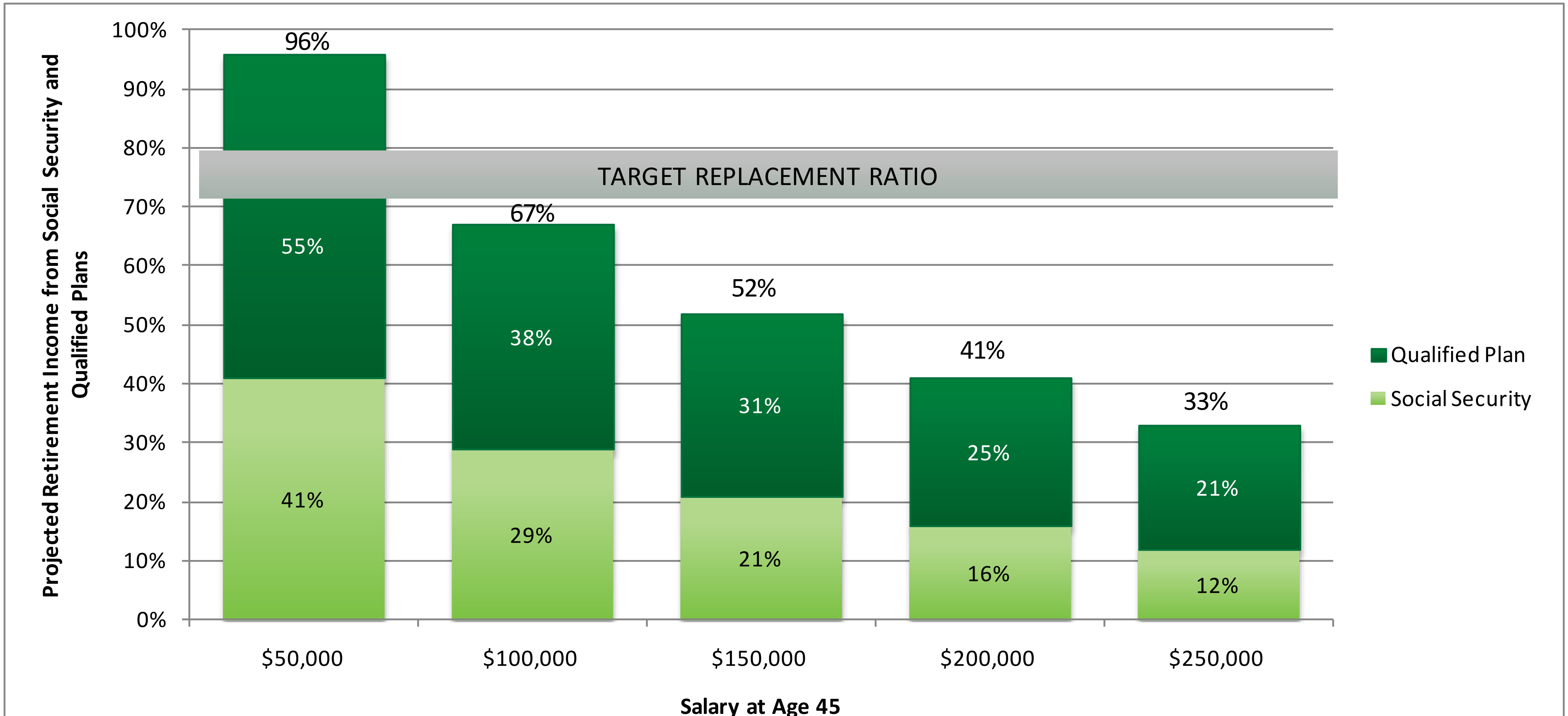
- Executive Objectives
  - Defer additional current compensation, reduce income tax
  - Accumulate sufficient wealth to maintain standard of living post-retirement

- Maximum Limits in qualified retirement plans restrict benefits for high wage earners

2012 Qualified Plan Limits

Qualified Plan Limit	Maximum
Elective Deferral Limit 401(k), etc.	$17,000 $22,500 if over age 50 Testing may further reduce limit for HCE’s
Defined Contribution Limit (aggregate)	$50,000
Defined Benefit Plan Distribution Limit	$200,000
Annual Compensation Limit	$250,000

Example – Impact of Limits in Qualified Plan



Executive age 45 contributes 10% of their pretax salary to a qualified plan. Employer matches $0.50 of the first 6% contributed. Salary increases 3% per year and contributions are limited to the maximum allowed by law. Contributions grow tax deferred at 7% annual interest. Account balance at 65 is paid out in 20 installments. The installments increase 3% per year to account for inflation, and after 20 years the account balance is zero. All distributions are taxed as ordinary income. Values shown include income from Social Security, an opening balance in the 401k, but assume no other sources of income.

All values shown are hypothetical, are not guaranteed and for demonstration purposes only. They are not indicative of any security available for sale and your experience will be different from that shown here. Past performance cannot predict future results.

NFP EB – How We Can Help

ADVISE

Plan Design Consulting

Documentation

Implementation & Enrollment

FINANCE

Case Design

Investment Option Analytics

Product Placement

SERVICE

Plan Administration & Recordkeeping

Asset Administration

Web Access

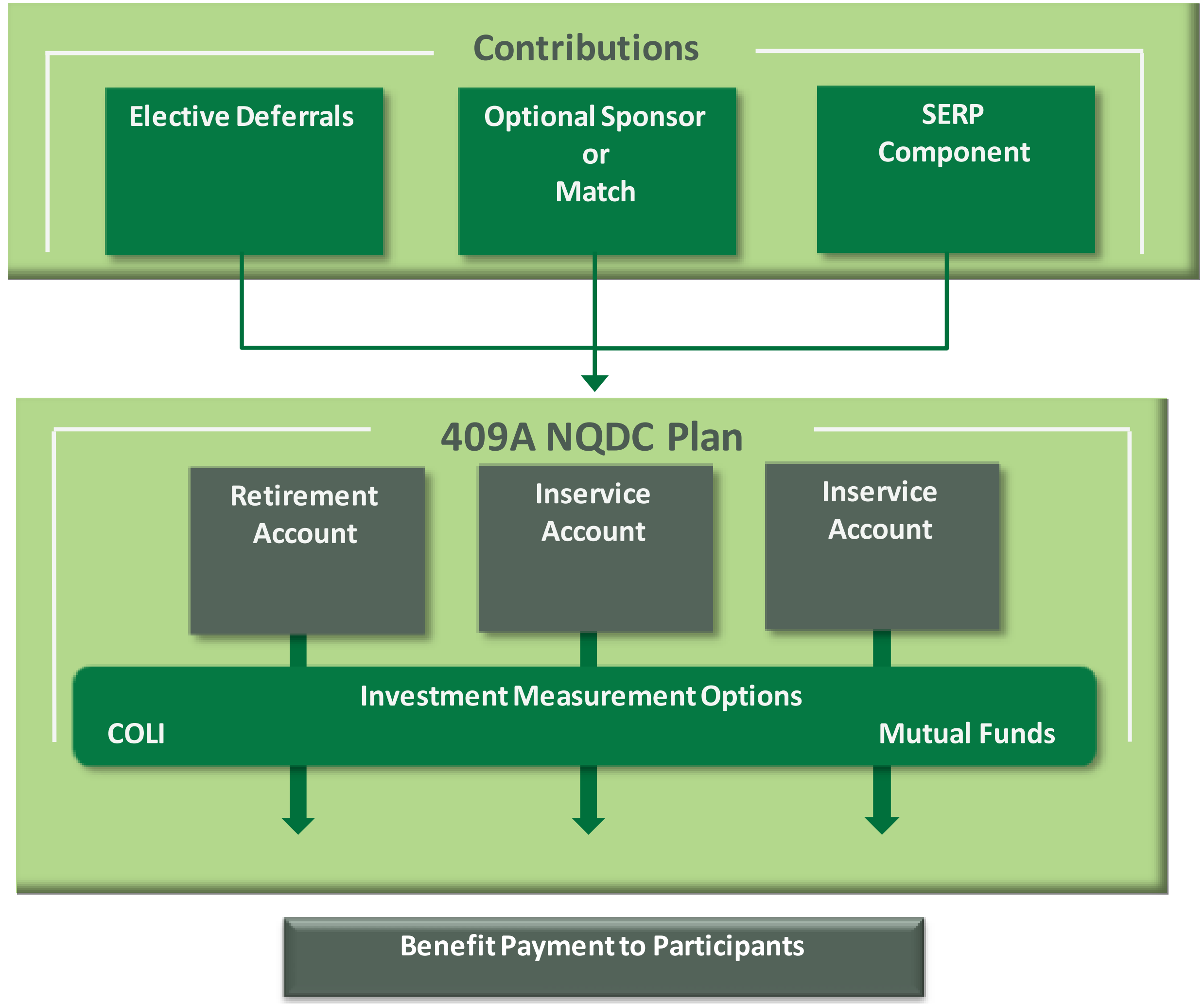
Design Guide

Eligibility
Contribution Formula
Deferral Maximums

Number of Accounts
Early Retirement
Vesting
Change in Control

Corporate or participant directed?
Death Benefits

Payout Form
Survivor Benefits



Challenges with Pass-through Entity Plans

- Dilemma
  - Partners seek maximum Distributable Income
  - Additional benefit cost/expense will reduce Distributable Income
- Addressing Stakeholder concerns
  - Founding Members (recognition for wealth created by growth of firm)
  - Near Retirees (will firm cash flows meet future benefit obligations?)
  - Younger and Future Partners (obligated for promises to former partners)
- Establishing a viable pathway to retirement which impacts all partners equitably

Stakeholder Concerns

Founding members

- Want to be recognized for the wealth that has been created by the creation and growth of the firm

Near-retirees

- May have high degree of loyalty to firm and to founding members
- Concerned that the firm will continue to create sufficient cash flows to meet future benefit obligations
- Late-career partners might have difficulty transitioning to another firm and maintaining current income

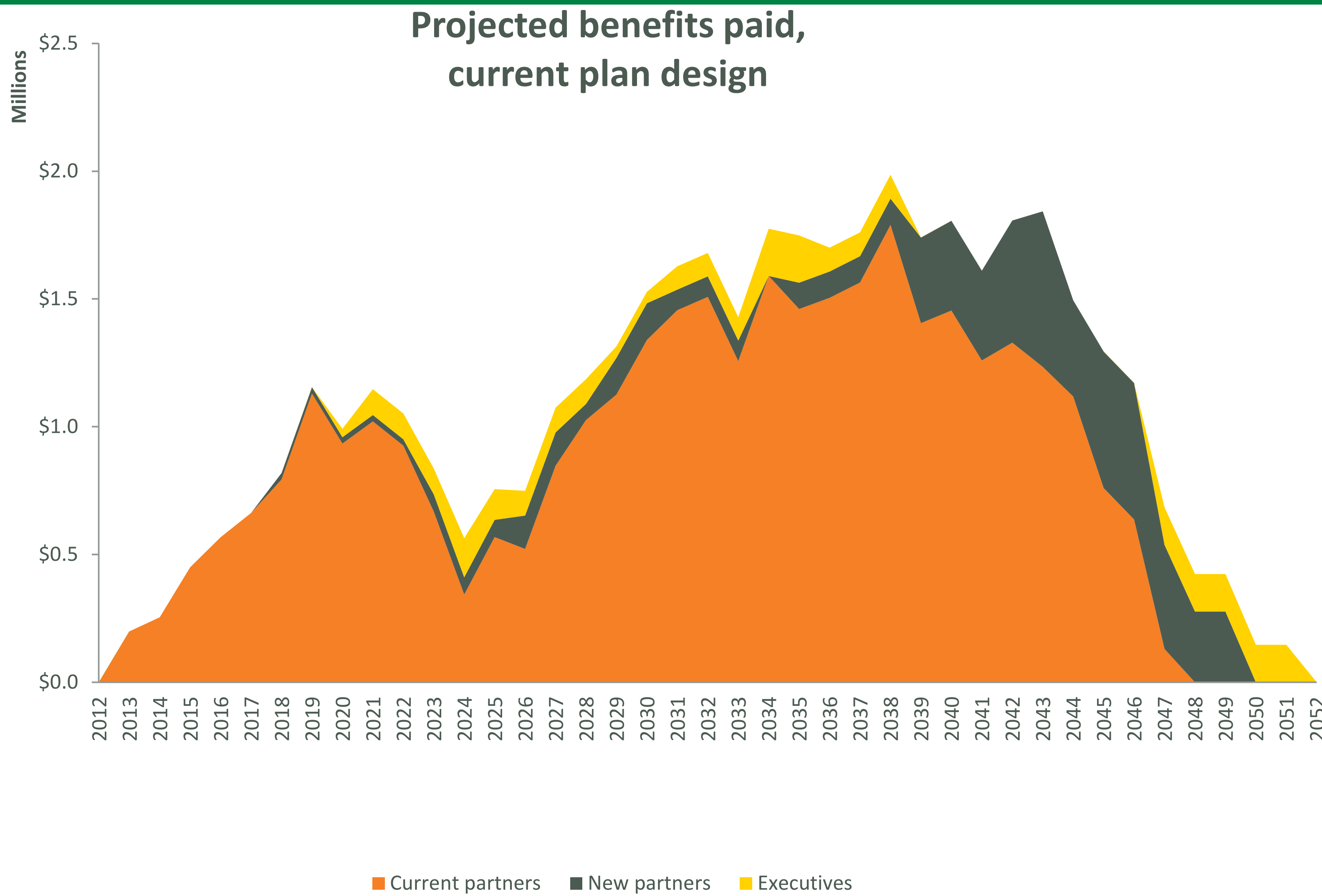
Younger partners

- Could believe that the financial rewards for attaining senior positions are significant
- May have a lower sense of loyalty to the firm
- May be less willing to be responsible for financial obligations to long-departed former partners
- Can more easily sustain a temporary reduction in income caused by the transition to another firm

Designing a Retirement Benefit Plan

- Most plans at partnerships are designed to cover all members
- The plans can take a number of forms:
  1) Stated Benefit: "Everyone gets $50,000 a year for five years"
  2) Defined Benefit: "For every year you work here, you get 2% multiplied by your final average salary"
  3) Cash Balance: "The company will contribute 5% of your compensation to an account; you can manage the investments in that account"
- Benefit payments are usually made for a specific number of years and then cease

Case Study


Projected benefits paid,
current plan design
Millions
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$1.0
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$0.0
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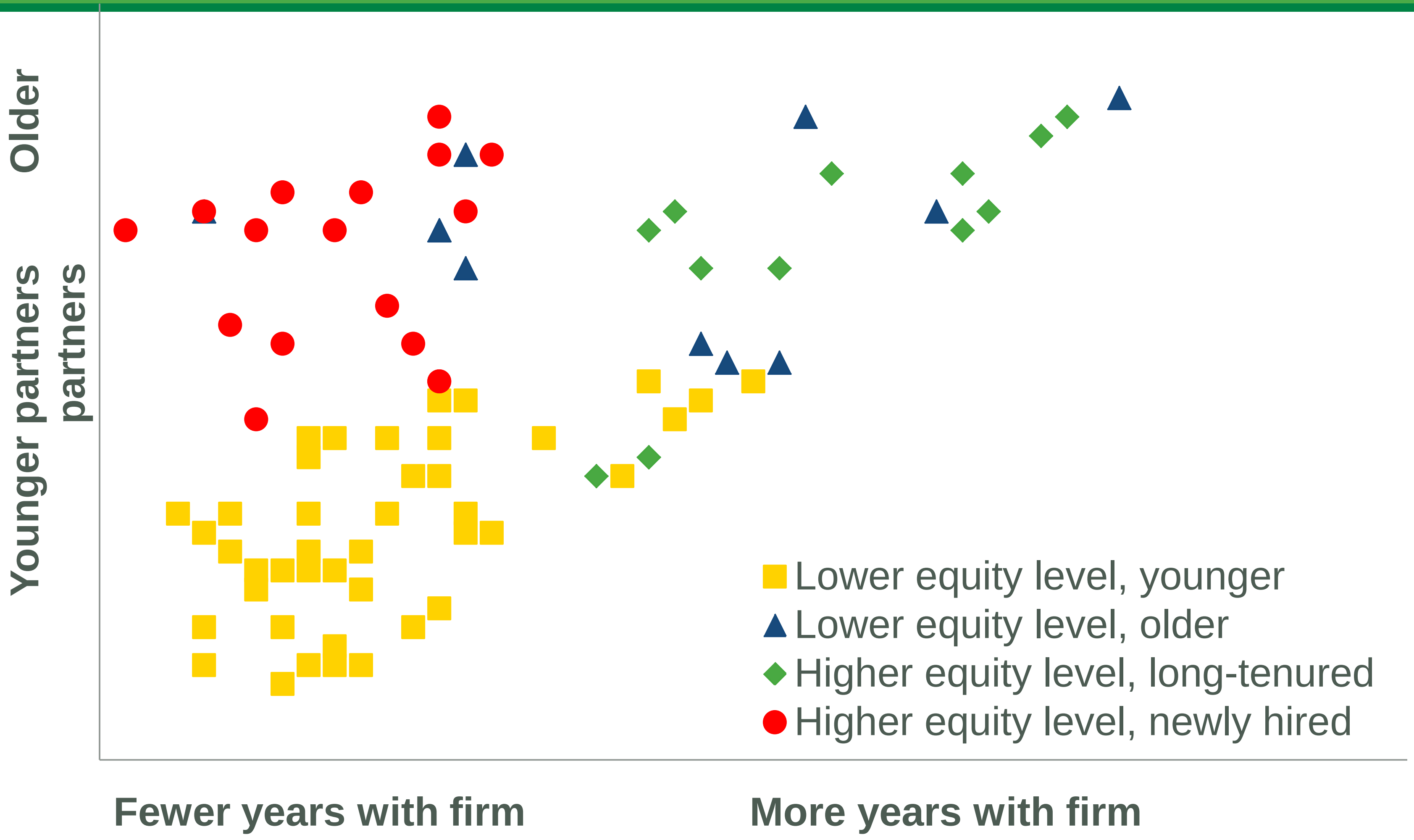
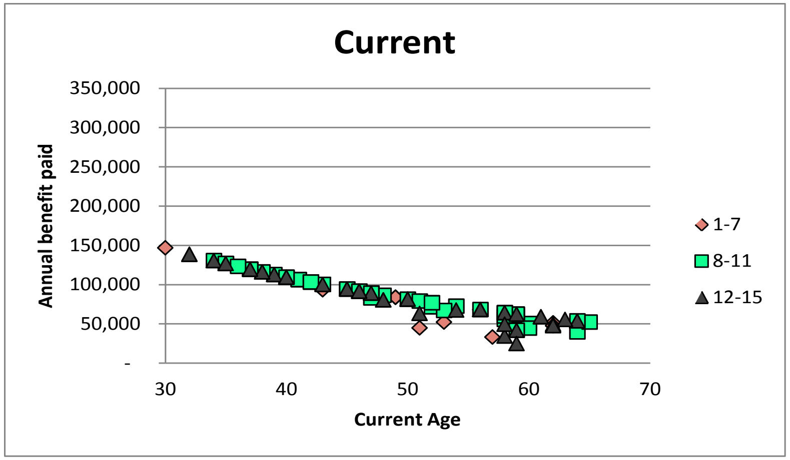
Current partners
New partners
Executives

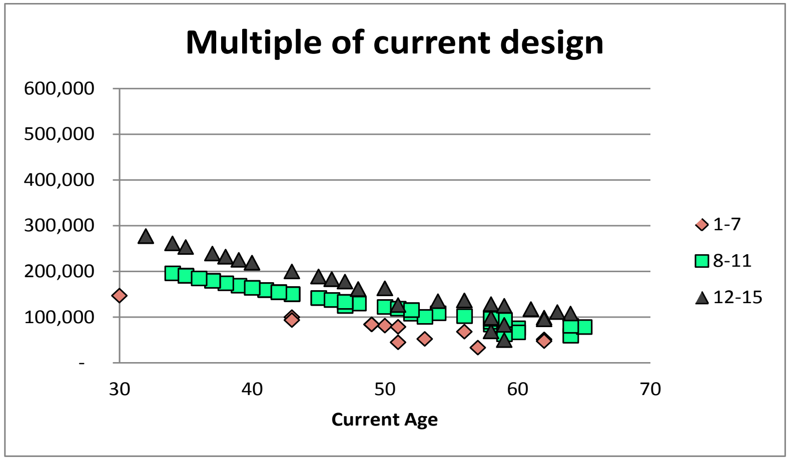
Case Study

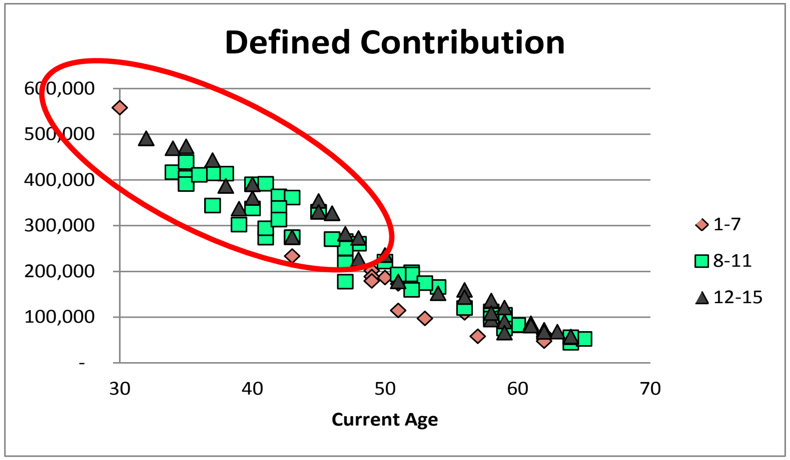


Hypothetical case illustration. The charts are analysis of design alternatives.

Analyzing Design Alternatives







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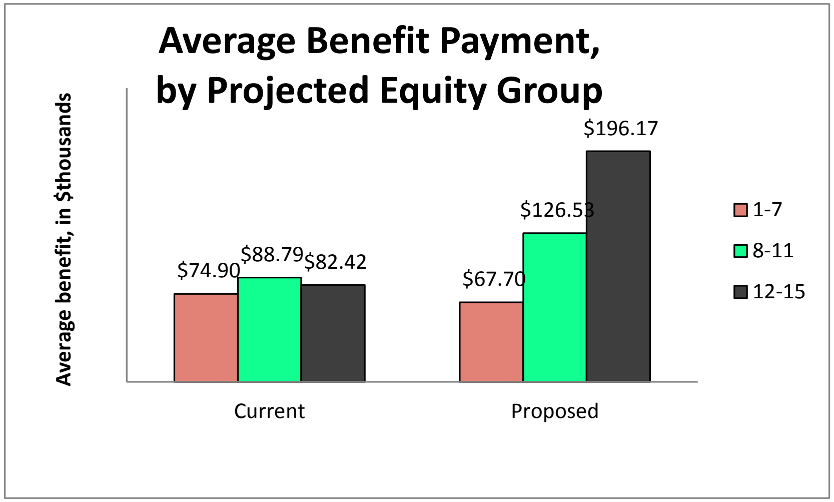
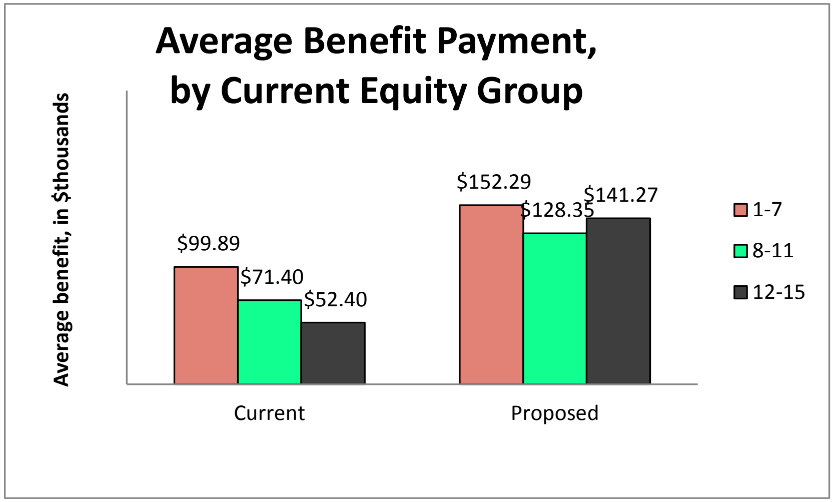
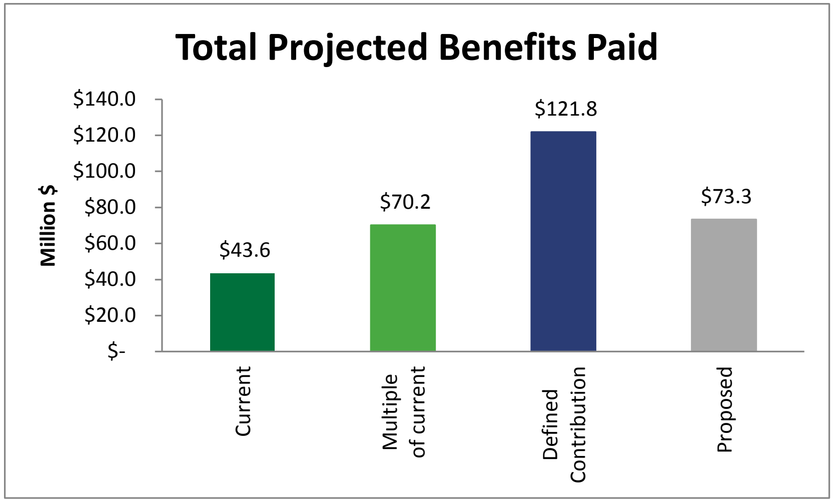
Analyzing Design Alternatives







Hypothetical case illustration. The charts are analysis of design alternatives.

Final Plan Design

- 1.25% per year of service
- Maximum of 15 years count toward formula
- Multiplied by final average salary (highest three of last five)
- Enhancement at higher equity levels
- Decrement at lower equity levels
- “Commitment” went from $400,000 a year to $1,000,000 a year

Hypothetical case illustration. The charts are analysis of design alternatives.

Financing the Obligation

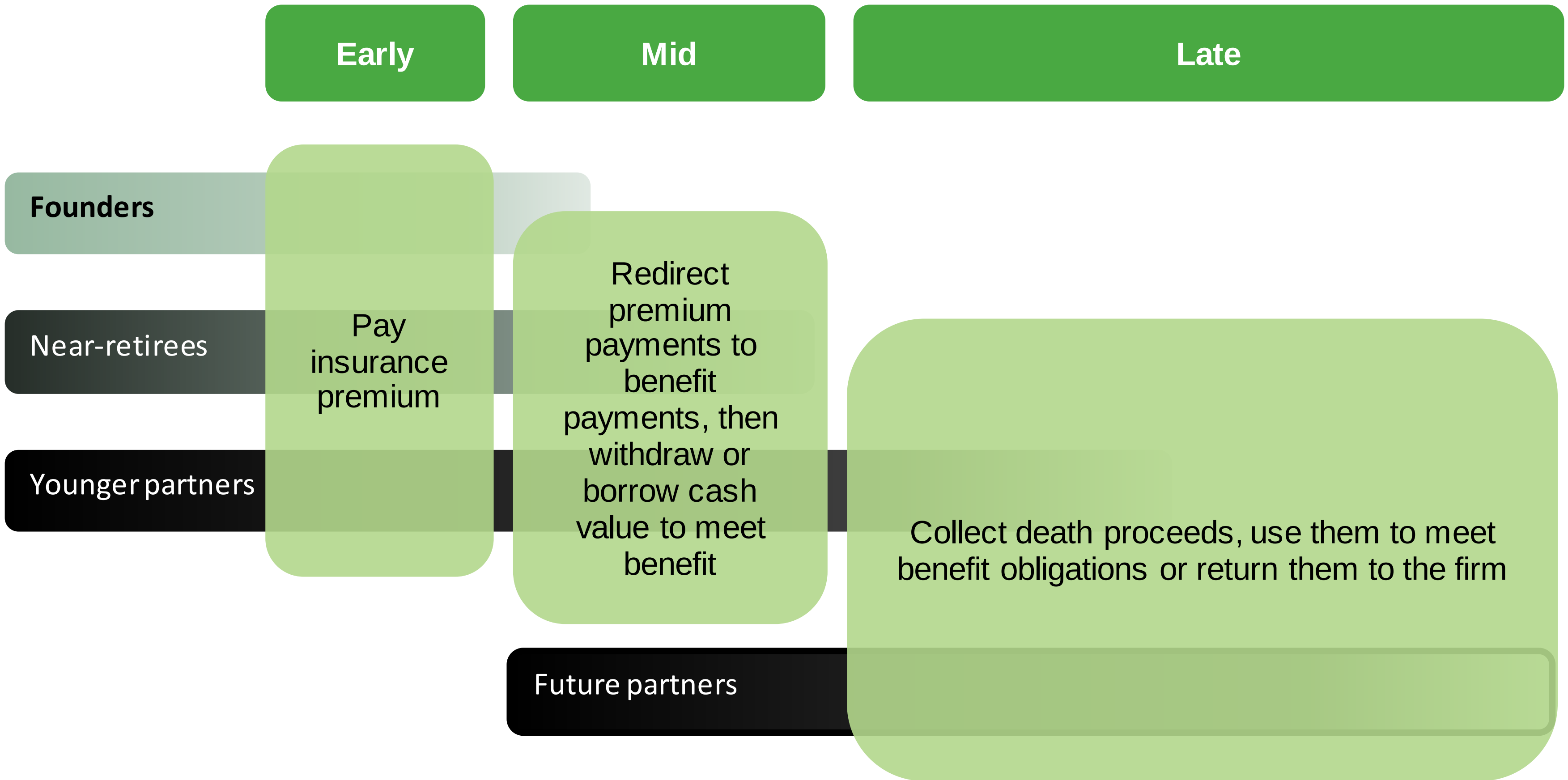
- A partnership that implements a retirement benefit implicitly obligates future partners to make good on the promises of the benefit plan
- Unlike traditional pensions, there is no legal requirement to pre-fund nonqualified plans
- This creates a tension between two desires 1) to maximize current distributable income and 2) to ensure that adequate reserves exist in the future to meet benefit needs

Financing the Obligation

- A desirable financing tool will have a number of characteristics
    1) Liquidity
    2) Transparency
    3) Provides confidence to all stakeholders that it will adequately meet cash flow needs
    4) Low cost
    5) Low administration requirements / low maintenance
    6) Tax efficiency

Financing the Obligation with Life Insurance

- One solution: an annual commitment from the firm, divided between benefit payments and premium payments



Outcomes

- A benefit design that meets the needs of the firm and its members
- Meaningful benefit level
- Viable path to retirement
- Source of cash when benefits come due
- A long-lived asset to meet a long-term need

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