WHITE PAPER

M Benefit Solutions®

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Noncash Executive Benefit Programs—FICA Tax Treatment

This white paper summarizes the FICA tax treatment of most noncash executive benefit programs. FICA tax treatment does not necessarily follow income tax treatment. This difference is especially notable in the context of nonqualified deferred compensation and retirement plans where the general rule of taxation that amounts taxable as wages are generally taxed when paid or "constructively" received is not followed for FICA taxation. Instead, a "special timing" rule is followed where amounts are taxed at the time the compensation is earned, or, if later, when such compensation vests (that is, the compensation is no longer subject to a substantial risk of forfeiture).

This paper is intended to limit the surprise and confusion that sometimes results when a new executive benefit program is implemented and the company and plan participants discover the tax results under FICA are not the same as the income tax results.

NONQUALIFIED DEFERRED COMPENSATION AND RETIREMENT PLANS

1 Plan Type	2 General Description	3 FICA Taxation
Supplemental Executive Retirement Plans	• Promises a benefit at retirement based on a formula or a stated dollar amount • Can be provided only to a select group of management employees or directors	• FICA taxes paid as benefits are vested and accrued under reasonable actuarial assumptions • However, an amount need not be FICA-taxed until the earliest date on which the amount deferred is "reasonably ascertainable." An amount deferred is "reasonably ascertainable" when there are no actuarial or other assumptions needed to determine the amount deferred other than interest, mortality, or cost-of-living assumptions. • If the benefit has been fully FICA-taxed prior to payment, then no FICA tax is due on payment • Benefits not FICA-taxed prior to retirement (e.g., benefit vests only upon retirement or benefit was not reasonably ascertainable prior to retirement) are FICA-taxed at retirement

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NONQUALIFIED DEFERRED COMPENSATION AND RETIREMENT PLANS

1 Plan Type	2 General Description	3 FICA Taxation
Employer-Paid Defined Contribution Plans	• Employer credits executive accounts with dollar amounts which are credited to an account credited with earnings based on an interest rate determined by the company or on market rates of return • Can be provided only to a select group of management employees or directors	• Employer contributions are subject to FICA tax when they accrue and vest • Market-rate earnings on vested amounts are not FICA-taxed • Above market-rate earnings on vested amounts are taxed as they accrue and vest • All earnings on unvested amounts are FICA-taxed when underlying contributions vest • No FICA tax when vested amounts are paid
Elective Deferred Compensation Plans	• Participants elect to defer payment of compensation (salary, bonus, and/or long-term compensation) which is credited to an account credited with earnings based on an interest rate determined by the company or on market investments • Can be provided only to a select group of management employees or directors	• Employee deferrals are subject to FICA taxation at the time of deferral • Market-rate earnings on deferrals are not FICA-taxed • Above market-rate earnings on deferrals are taxed as they accrue and vest • No FICA tax when deferred amounts and earnings are paid • All employer contributions (e.g., company match) are FICA-taxed as described under Employer-Paid Defined Contribution Plans

STOCK AND EQUITY PLANS

1 Plan Type	2 General Description	3 FICA Taxation
Stock Options	• Nonqualified stock options (NQSOs) are options to purchase employer stock at a stated exercise price. Incentive stock options (ISOs) are also options to purchase employer stock but are subject to special tax rules and receive certain tax benefits. • NQSOs and ISOs are typically granted to key employees, but may be offered to all employees • Directors can only receive NQSOs	• NQSOs—ordinary income at time of exercise (based on value at time of exercise less employee cost basis). FICA tax is due on this amount at exercise. No further FICA taxation. • ISOs—no income tax at exercise; typically capital gains treatment at disposition of stock. No FICA taxation at any time.
Stock Appreciation Rights ("SARs")	• Right granted to receive the appreciation in employer stock between a stated exercise price and the fair market value at time of exercise • Typically granted to key employees, but can be offered to all employees (very rare) • Can be offered to outside directors	• Value of benefit received is taxable as ordinary income when received • FICA tax is due at time of exercise
Restricted Stock	• Grant of stock subject to vested provisions based on either time or performance • Typically key employees, but can be offered to all employees (very rare) • Can be offered to outside directors	• If Code Section 83(b) election is made, ordinary income tax is paid on value at time of grant • If 83(b) election is not made, ordinary income tax is paid on value at time restrictions lapse • FICA tax is due at time employee recognizes ordinary income
Phantom Stock Plans	• Grant of right to value of stated number of employer shares of stock usually payable in cash • Select group of management/key employees • Can be offered to outside directors	• Rights are subject to FICA taxation when they vest, that is, they are treated in the same manner as nonqualified deferred compensation plans • Market rate income (i.e., stock appreciation and, if applicable, dividend payments) on vested right is not subject to FICA taxation • Appreciation and dividends credited on unvested shares are subject to FICA taxation when shares are vested

WELFARE BENEFIT PLANS

1 Plan Type	2 General Description	3 FICA Taxation
Shared Death Benefit Plans ("Split Dollar")	• Death benefit from life insurance policy on life of executive is split between company and executive's beneficiary • Select group of management/ key employees. Often broader eligibility than nonqualified retirement programs. • Can be offered to outside directors	• Death benefit proceeds are income tax free to the beneficiary and are not subject to FICA • The insured pays annual taxes on "imputed income" based on value of life insurance coverage • FICA tax is paid on value of life insurance coverage
Supplemental Long-Term Disability ("Income Protection")	• Long-term disability insurance polices specifically designed for executive marketplace providing protection in addition to that may be available under the company's general disability coverage • Provided to key employees	• Employer-paid premiums can be structured as either taxable or non-taxable income to the employee • If premiums are treated as taxable then any benefits paid are non-taxable to employee. If premiums are treated as non-taxable then any benefits paid are taxable to employee. • FICA tax is due on the amount of premium that is treated as taxable income to employee

Qualified Long-Term Care Insurance ("Asset Protection")	• Key employees (and, depending on design, their family members)
	• Can be offered to outside directors (and, depending on design, their family members)
		• Employee pays no income or FICA tax on company-paid premiums
		• Reimbursement benefits are not included in income
		• Per diem or indemnity benefits are not included in income except those amounts that exceed the greater of:
		  • Total qualified LTC expenses, or
		  • $260 per day (in 2007)
		• LTC benefits are not FICA-taxed

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