# Rabbi Trusts and Changes in Control Situations

Employers who maintain non-qualified deferred compensation plans or other supplemental employee retirement plans for their senior executives and other highly compensated employees may want to consider establishing a “rabbi trust” (so named because the first such arrangement was established by a synagogue to provide deferred compensation to its rabbi). Because non-qualified deferred compensation plans are typically unfunded—they are an unsecured promise to pay compensation in the future—employees face a risk that their deferred compensation will not be paid if their employer has a “change of heart” or is sold to another entity (a “change in control”). Establishing a rabbi trust helps alleviate these concerns.

Rabbi trusts often are established prior to a “change in control” of an employer to ensure that when the employer is taken over, the new company does not have the power to change the trust’s terms. By its terms, a rabbi trust can provide that the trust’s beneficiaries must consent to amendments that would result in a reduction in their benefits.

## Senior Executive Protection

A rabbi trust provides security for employees who participate in their employer’s deferred compensation plans that their deferred compensation will be paid at a future date, generally upon retirement, death or termination of employment without cause. If the trust is irrevocable, any trust assets cannot be used by the employer for purposes other than funding deferred compensation obligations. Appointing an independent third party trustee ensures that once the employer makes contributions to a rabbi trust, the employer’s ability to reclaim such funds is significantly restricted. While the employer could not withdraw funds from the rabbi trust to pay employee wages or satisfy other obligations, the funds remain at risk to claims of the employer’s creditors if the employer files for bankruptcy or becomes insolvent.

## Rabbi Trust Taxation

Rabbi trusts also provide tax advantages for employees. Because the employer’s creditors could potentially access the trust assets, the assets are considered the employer’s until they are distributed. Contributions made to a rabbi trust are not taxable to the employee as wages until they receive payment of their benefits pursuant to the terms of the deferred compensation arrangement. The employer is responsible for the payment of taxes on any income earned by the rabbi trust.

## ERISA

As long as a rabbi trust is maintained for the benefit of a select group of management or highly compensated employees, it is generally exempt from most ERISA requirements.

## Use of Life Insurance to Fund a Rabbi Trust

Corporate-owned life insurance ("COLI") often is used as a funding vehicle for rabbi trusts because it provides a tax-advantaged investment vehicle while seeking to provide employees with the peace of mind that funds will be available to pay the benefit obligations under their deferred compensation plans. If a rabbi trust is funded using COLI, the trustee of the rabbi trust is the owner and beneficiary of the policy; neither the employee nor his or her beneficiary has an interest in the policy.

**Contact your Newport Group representative for more information.**

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