2024 Compensation Planning for Executives

As a corporate executive, planning around your compensation can be exceedingly complex. Attempting to make optimal decisions around cash payments, stock options, other long-term incentives, deferred compensation, and more — all while leading a company — is no simple feat, even for those well accustomed to it.

To help you navigate the current planning environment, below are examples of strategies to discuss with your advisors.

Accelerate Income Where Possible

Although previous tax policy proposals to raise the top personal income tax rate have not made their way into law, higher earners could soon face higher income taxes nonetheless. In March 2024, the Biden Administration sent Congress its fiscal year 2025 budget that increases the top rate from 37 percent to 39.6 percent for single filers making over $400,000 a year and married couples making more than $450,000 per year. This percent increase restores the percentage that was in place before 2017[1].

As an executive, you may have the ability to control when you receive certain income, including from stock options or restricted stock units (RSUs). Before the end of the year, you may want to consider accelerating this income in anticipation of potentially higher tax rates down the road — and as part of your ongoing effort to diversify your portfolio.

Examples include choosing to exercise options (particularly those closer to expiration) or making a Section 83(b) election for your RSUs, which allows you to pay taxes at the time of grant versus when the shares vest. However, before making an 83(b) election, you should also weigh the risk that the stock price declines, or capital gains tax rates rise, in the future, which would mitigate the benefits of the election.

Transfer Wealth to Your Family Ahead of Lower Exemption Amounts

The Tax Cuts and Jobs Act (TCJA) of 2017 approximately doubled estate exemptions. The increased exemption amounts, which sit at $13.61 million for individuals and $27.22 million for couples in 2024 under TCJA, are scheduled to run until December 31, 2025, (unless Congress makes the tax code changes permanent), after which the basic exclusion amount is set to revert to the 2017 level of $7 million per individual and $14 million for married couples, plus inflation adjustments[2]. Also, it is possible — albeit unlikely — that the exemption could be lowered sooner by additional legislation.

Either way, now may be a good time to take advantage of this unique planning opportunity and remove additional assets out of your taxable estate. To do so, work with your financial advisor to understand how much of your current assets are needed to fund expenses during your lifetime and approximately how much will be left to gift. In conjunction, you may also want to talk to your advisors about funding (or finishing funding) an appropriate grantor trust that could allow you to remove taxable assets — and possibly, future appreciation of those assets — to family members with little to no gift tax.

Contribute to a Roth IRA while "Back Doors" Still Exist

Roth accounts can be especially attractive to high earners. Investment growth and future withdrawals are tax-free after age 59 1/2, and required minimum distributions aren't required at age 73, as they are with traditional pre-tax accounts.

However, under current law, taxpayers with modified adjusted gross income (in 2024) of at least $161,000 ($240,000 if married, filing jointly) are prohibited from contributing to a Roth IRA. "Backdoor" and "mega backdoor" Roth contributions are strategies that allow high earners to participate in Roth accounts.

A "backdoor" Roth contribution strategy works as follows:

- Although higher earners (as defined above) are barred from contributing to a Roth IRA, they are allowed to convert traditional IRA assets into a Roth IRA.
- When converting traditional IRA assets into a Roth IRA, taxpayers owe tax on the gains that have accrued from their contributions.
- To avoid paying taxes on gains from converting traditional IRA assets into a Roth IRA, taxpayers can make contributions to their traditional IRA account and then immediately convert those funds into Roth IRAs, leaving no time for the money to grow and shielding future appreciation from future taxes.

This strategy was targeted by lawmakers in 2021 and 2022 as part of tax reform proposals, which never materialized but highlighted the strategy's vulnerability to future tax law changes.

Likewise, future legislation also could prohibit a similar strategy that can enable even greater tax savings — "mega backdoor" conversions. These conversions combine two features of employer-sponsored retirement plans: after-tax contributions and a Roth 401(k) that allows after-tax Roth conversions. If both of these features are offered, participants can take full advantage of the $69,000 annual retirement savings plan contribution limit in 2024 (for both employee and employer contributions) by making after-tax contributions, and then converting those contributions to a Roth 401(k).

Create a Personal Cash Flow Plan

If you haven't already, seek to optimize cash flow in your personal life, similar to how you would in your business. There are different ways to approach this with your financial advisor, but one strategy is to build cash flow statements and balance sheets based on your lifestyle and expected expenditures in future years and update them each year to reflect your spending and savings choices and market conditions. This allows you to align your investment choices — and liquidity profile — with your future liabilities.

Investing Excess Cash

Stocks are up nearly 15% year-to-date, with bonds slightly in the green, up 2%. Markets have been volatile this year, awaiting both interest rate cuts from the Fed and the U.S. presidential election. However, the outlook remains solid with U.S. GDP and corporate earnings growing nearly 2% and 10% respectively this year. Time in the market usually beats timing the market and this holds true even in uncertain times. Excess cash should be put to work in line with your investment objectives and long-term goals across equities, fixed income, and alternative investments.

Building a Long-Term Plan for Your Stock Options

To make the most out of your option grants, build a comprehensive strategy with your financial advisor that considers a wide range of variables, including taxes, your risk tolerance, your balance sheet, the financial outlook for your company and your career stage. As part of this exercise, understanding the technical aspects and tax treatment of each of the two main types of options is important:

- **Incentive stock options (ISOs)** are not taxed at grant, vesting or exercise (although could have alternative minimum tax consequences). Instead, they are taxed as long-term capital gains once the underlying shares are sold, assuming holding requirement periods are met.
- **Non-qualified stock options** are taxed at ordinary income tax rates when they are exercised.

In addition to different tax treatments, these two types of options have other technical aspects that make them better suited to serve different purposes in your wealth plan. For example, non-qualified stock options can be a good candidate to satisfy your lifetime gifting goals, as they can be transferred once fully vested to your family or to a trust to the benefit of your family (while you remain responsible for the income tax generated once they are sold).

Factoring State Taxes Into Your Deferred Compensation Election

If you plan to relocate to a different state when you retire, consider the state tax implications of your deferred compensation elections. If you elect a distribution period of less than 10 years, income will be taxed by the state in which it was earned, whereas if you elect a distribution period of 10 years or more, the income will be taxed by the state in which you primarily reside at the time it is paid.

You should also work with your advisor to analyze the impact of taking a lump sum payout versus a payout over a period of years, while considering any potential income gaps during retirement. For example, many executives retire before they are required to begin taking required minimum distributions from retirement accounts (currently at age 73). In these situations, deferred compensation payments can serve as a tax-efficient way to bridge your income needs during the "in-between" years.

Lean on Your Advisor

The above are only examples of strategies that can be implemented to optimize compensation decisions — and ultimately achieve more for yourself and the people and causes you care about. To determine the best strategies for your specific circumstances, and take advantage of the current environment, please reach out to one of our advisors.

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FOOTNOTES

[1] House, W. (2024, March 10). FACT SHEET: The president's budget cuts taxes for working families and makes big corporations and the wealthy pay their fair share. The White House. https://www.whitehouse.gov/briefing-room/statements-releases/2024/03/11/fact-sheet-the-presidents-budget-cuts-taxes-for-working-families-and-makes-big-corporations-and-the-wealthy-pay-their-fair-share

[2] Oshagbemi, C., & Sheiner, L. (2024, September 5). Which provisions of the Tax Cuts and Jobs Act expire in 2025? Brookings. https://www.brookings.edu/articles/which-provisions-of-the-tax-cuts-and-jobs-act-expire-in-2025/

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