

Executive Bonus Arrangements



The Concept...

- An executive bonus arrangement is an employee benefit in which the employer agrees to pay premiums on personal life insurance on the life of a selected employee or employees.

The Purpose...

- The employer creates additional rewards for specific individuals such as company executives or other key employees.
- The employee enjoys favorable recognition with added life insurance protection and the potential for increased retirement income.

The Process...

- Terms of the arrangement are usually spelled out in a written agreement.
- The employee applies for and owns an insurance policy on his or her life.
- The employer pays the annual policy premium or provides a yearly cash bonus which the employee uses to pay the premium.
- The annual premium payment or cash bonus is deductible by the employer, provided the insured employee's total compensation is "reasonable" in the IRS's opinion.
- Excess—or "unreasonable"—compensation is not deductible by the employer and, like other compensation, is includable in the employee's gross income.
- The policy's cash values belong to the employee who can use them for emergencies or to supplement income after retirement.
- When the employee dies, his or her beneficiary typically receives the policy's death proceeds free of federal income tax.



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The Bottom Line...

Executive bonus arrangements provide a tax-favored way to reward valued employees on a selective basis, avoiding anti-discrimination rules and giving the recipients added recognition in the form of valuable life insurance protection and other benefits.



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What Is Executive Bonus?

The executive bonus arrangement is an easy-to-implement employee benefit giving employers complete control in providing hand-picked employees with individual life insurance protection, supplementing broad-based group term life plans that may be in place.

The arrangement is simplicity itself, with no burdensome reporting requirements or problems with anti-discrimination rules imposed by the IRS. Employees secure additional insurance protection while employers have total discretion in selecting, and choosing how much protection to provide.

How Does It Work?

The employee applies for and owns a life insurance policy on his/her life, and names a personal beneficiary.

The employer pays an annual bonus to the employee either in cash or indirectly as a premium on the life insurance policy.

The result is employer-provided life insurance owned by the employee and ultimately benefiting the employee's personally selected beneficiaries. It's used by employers to reward selected key employees for significant contributions to the company's bottom line. (The arrangement is generally not recommended for S corporation owners or partners since those businesses are not separate taxpaying entities.)

What Are the Tax Consequences?

The employer reports the bonus to the employee and the IRS. Some arrangements provide for an additional cash bonus to offset anticipated payroll and income taxes. This results in a zero net cost to employees.

Since the annual premium payment or bonus is taxed to the employee, it is generally deductible by the employer provided the employee's total compensation is "reasonable." If it's unreasonably high in the IRS's judgment, the excess compensation is not deductible by the employer and, like other compensation, is taxed to the employee.



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As owner of the policy, the employee has access to its cash value. The accumulating, tax-deferred values may exceed the employee's annual tax liability after a few years and can be used to cover those costs if the employee chooses to take loans or partial surrenders. Or they can be left in the policy for unanticipated emergencies or to supplement future retirement income.

What Are the Benefits?

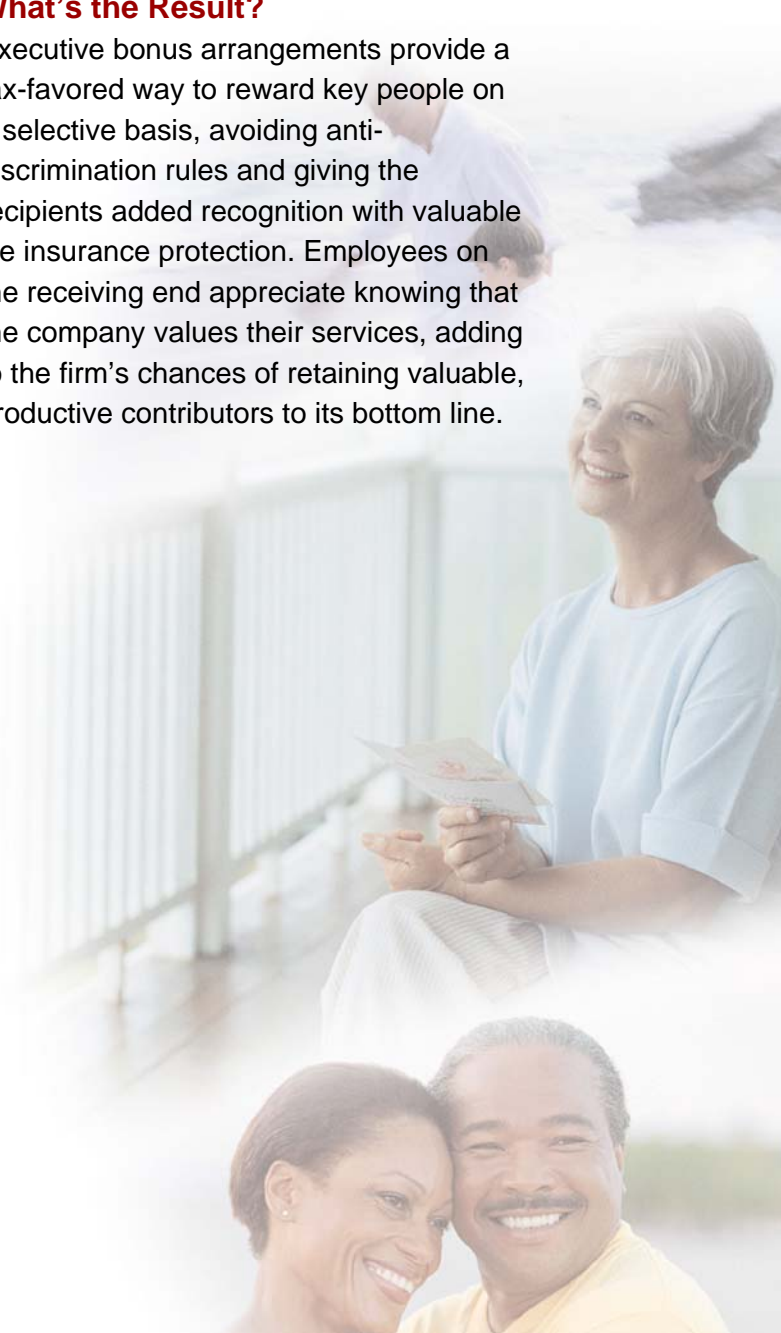
For the **employer**, the executive bonus arrangement offers complete control in singling out and rewarding key executives and other employees with employer-financed, personal life insurance. It's easy to create and administer, with few restrictions or reporting requirements. Not only can specific employees be selected, but the amount of the policy can vary among individuals. And it provides an effective way to encourage selected employees to remain with the company.

For the **employee**, the arrangement provides additional life insurance protection funded with employer dollars. Cash values, which grow on a tax-deferred basis, are available for potential emergencies or to supplement future retirement income.

Death benefits paid to the employee's personal beneficiary are generally income tax-free. And because the policy is owned by the employee and not the business, it is portable if the employee leaves the organization.

What's the Result?

Executive bonus arrangements provide a tax-favored way to reward key people on a selective basis, avoiding anti-discrimination rules and giving the recipients added recognition with valuable life insurance protection. Employees on the receiving end appreciate knowing that the company values their services, adding to the firm's chances of retaining valuable, productive contributors to its bottom line.



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1. The employer pays for a policy on the selected employee's life in the form of premiums or cash bonuses (deductible to the extent that the total compensation is reasonable), which are forwarded to the life insurance company.



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2. The payments are deductible (to the extent the employee's total compensation is reasonable) by the employer...

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4. As owner of the policy, the employee has access to the policy's accumulating cash values* and names his or her personal beneficiary.

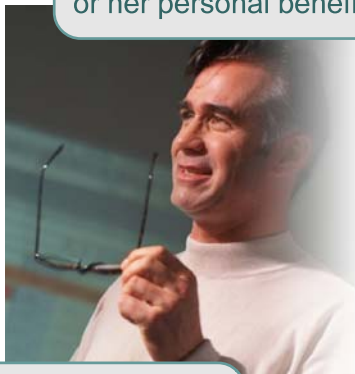
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5. At the employee's death, the beneficiary receives the policy's death proceeds, generally free of federal income tax.



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3. ...and reported to the employee as additional compensation each year.



*As an option, the employer may place restrictions on the employee's access to the cash value.

The Result...

The employer creates additional financial rewards for a valued company executive or shareholder-employee. The employee enjoys favorable employer recognition with added life insurance protection and the potential for increased retirement income.

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