



Business Planning

Executive Bonus Arrangements

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EXECUTIVE BONUS ARRANGEMENTS

The Concept...

An executive bonus arrangement is an employee benefit in which the employer agrees to either:

- ◆ pay premiums on personal life insurance coverage for a selected employee or employees, or
- ◆ provide a yearly cash bonus that the employee uses to pay the premiums on personal life insurance.

The Purpose...

- ◆ The employer creates an employee benefit that rewards specific individuals such as company executives or other valuable employees.
- ◆ The employee enjoys favorable recognition, added life insurance protection and the potential for increased retirement income.

The Process...

- ◆ The employer spells out the terms of the arrangement 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 employer may deduct the annual premium payment or cash bonus as long as the insured employee's total compensation is deemed "reasonable" by the IRS.
- ◆ Excess or "unreasonable" compensation is not deductible by the employer and, like other compensation, is included in the employee's gross income.



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- ◆ The policy's cash value belongs to the employee and can be used by the employee for emergencies or to supplement income after retirement.
- ◆ When the employee dies, the beneficiary typically receives the policy proceeds free of federal income tax.

The Bottom Line...

Executive bonus arrangements can provide a simple, tax-favored way to reward valued employees on a selective basis. Employees enjoy the benefit of life insurance protection, access to cash values and the potential for increased retirement income.



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Summary

WHAT IS EXECUTIVE BONUS?

An executive bonus arrangement is an easy-to-implement employee benefit that provides employers with the opportunity to selectively reward hand-picked employees with individual life insurance protection, supplementing any broad-based group term life plans in place.

Executive bonus arrangements are simple and easy to explain to employees. Also, there are no burdensome reporting requirements or anti-discrimination rules imposed by the IRS.

HOW DOES IT WORK?

The employee applies for and owns a life insurance policy on his or 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, employee-owned life insurance that ultimately benefits the employee's chosen beneficiaries. Employers use it 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 tax-paying 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."



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If compensation is judged unreasonably high by the IRS, the excess compensation is not deductible by the employer and, like other compensation, is taxed to the employee.

As policy owner, the employee has full access to cash values. The accumulating tax-deferred values may exceed the employee's tax liability after a few years and can be used to cover those costs if the employee takes a loan or a partial surrender. The employee can also leave the cash value in the policy for emergencies or to supplement future retirement income.

WHAT ARE THE BENEFITS?

An executive bonus arrangement provides employers with an opportunity to recognize and reward executives and other key employees on a selective basis with employer-financed, personal life insurance. It is easy to implement and administer, with few restrictions or reporting requirements. The employer can tailor each policy with a face amount designed to effectively encourage the selected employee to remain with the company.

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

Death benefits paid to the employee's chosen beneficiary are generally income tax free. In addition, because the policy is owned by the employee and not the business, it is portable should the employee leave the organization.

WHAT'S THE RESULT?

Executive bonus arrangements provide a tax-favored reward to key people on a selective basis, avoiding anti-discrimination rules and giving recipients valuable life insurance protection. Employees appreciate knowing that the company values them, which increases the firm's ability to retain valuable, productive contributors to the bottom line.



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