



Rewarding key employees

Executive bonus plan

Rewarding, retaining and attracting key employees is a high priority for successful businesses. The cost to an organization for losing a valuable employee can be substantial. Enhancing employee benefits can often provide advantages to an employer, as well as its employees. The choice of benefits for employees will depend on considerations, such as the level of employee interest in the benefit, costs, tax implications and plan administration.

For highly compensated key employees, standard benefits may fall short in meeting their future retirement or other financial needs. An executive bonus plan is a benefit that can offer value to employers and the highly compensated key employees they wish to reward.

What it is

An executive bonus plan is a bonus arrangement that allows employers to selectively offer permanent life insurance to certain key employees. The key employee owns the policy and the cash value, and selects the beneficiary to receive death benefits. The employer pays policy premiums as a bonus, which is taxable compensation to the key employee and income tax-deductible by the employer.

What it does

Supplements qualified retirement plan and group term survivor benefits by allowing key employees the opportunity to receive permanent life insurance above the amount the employer offers to all employees. This plan can provide death, disability and retirement benefits to key employees.

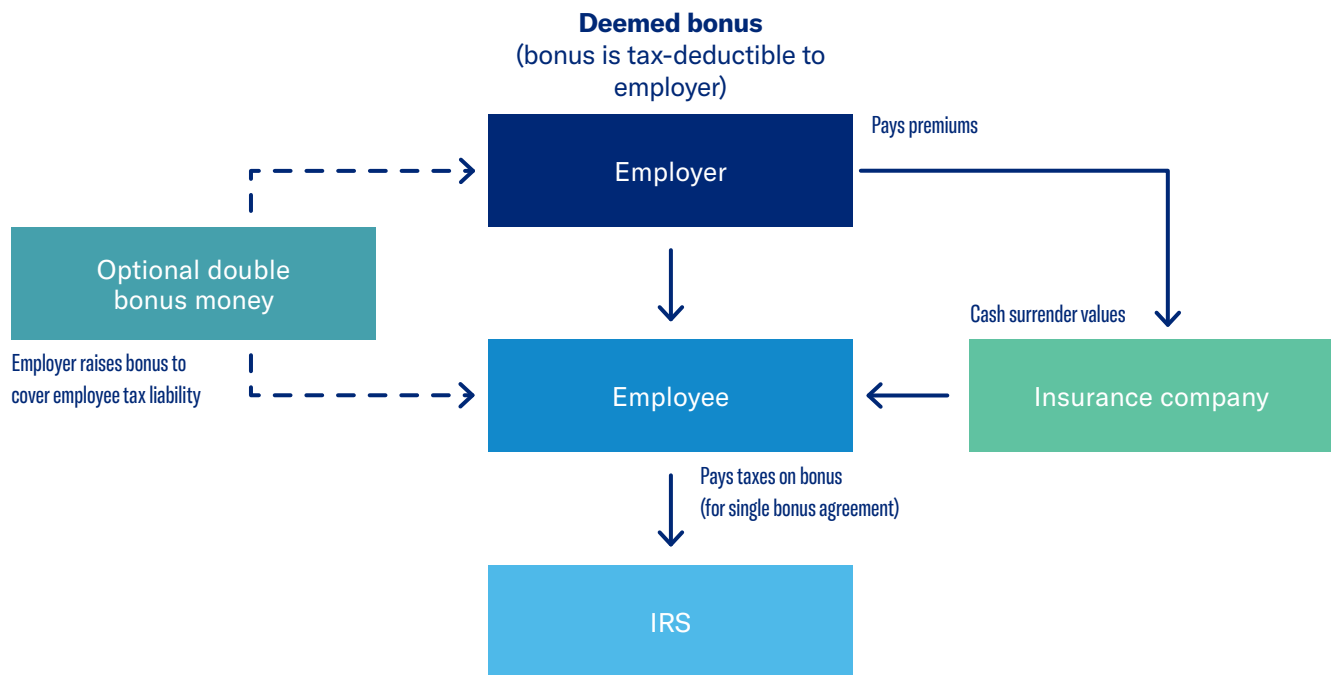
How executive bonus plans work

While living

- The employer pays policy premiums and receives a current income tax deduction, provided the key employee's compensation is reasonable.
- The key employee includes the amount of the premiums paid by the employer as gross income.
- The key employee may receive potentially income tax-free withdrawals and loans from the cash surrender value.¹

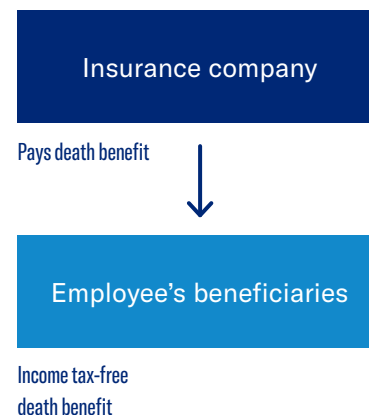
With optional agreement

- The employer can recover the cash value of the policy if the key employee breaches the agreement under a restricted premium plan, and the premiums paid by the employer will be tax-deductible and included in the key employee's income.
- The employer can restrict the key employee's access to the policy cash value with a Restrictive Executive Bonus Arrangement (REBA).



Upon death

- The proceeds are received income tax-free by the beneficiary, whether an individual, corporation, partnership, trustee or the key employee's estate (IRC Reg. 1.101-1).
- If the beneficiary is a corporation, the proceeds may be subject to corporate alternative minimum tax rules.



¹ Under current federal tax rules, you generally may take income tax-free withdrawals up to your basis (total premiums paid) in the policy or loans from a life insurance policy. If the policy is a modified endowment contract (MEC), all distributions (withdrawals or loans) are taxed as ordinary income to the extent of gain in the policy and may also be subject to an additional 10% premature distribution penalty prior to age 59½, unless certain exceptions are applicable. Withdrawals reduce the policy's cash value and death benefit and increase the chance that the policy may lapse.

Employer options

If the employer would like more control over the executive bonus plan, there are other options available for the agreement that are sometimes called a Restrictive Executive Bonus Agreement (REBA), a restricted premium plan, and the Bonus and Tax Loan (BATL Plan®).

REBA

This option may be included in an executive bonus plan agreement and is designed to limit the key employee's access to the policy cash value until a future date, such as 10 years. Death benefits are not restricted for the beneficiaries. Since the rights to the policy are not forfeitable, each premium payment is taxable compensation to the key employee and income tax-deductible by the employer.

Restricted premium plan²

The restricted premium plan option allows the employer to recover the cash value of the life insurance policy if the key employee breaches the agreement, such as by leaving the company during the restricted (forfeiture) period. In this case, both parties fully intend that the key employee will meet the obligations of the arrangement and the restriction will be waived. For this reason, after the premium is paid by the employer, the premium payment is taxable compensation to the key employee and may be income tax-deductible by the employer. The advantage to the key employee is no taxable compensation on the growth of the cash value of the policy at the expiration of the restricted period.

BATL Plan^{®3}

This plan is an attractive wrinkle to the traditional executive bonus plan. In these plans, the employer gives the employee an annual bonus and then provides loans to the employee to pay the income taxes payable on the bonus.¹ The employee owes loan interest to the employer on the outstanding loan and would be required to repay any amounts owed to the employer if he or she left the company, or from the death benefit, if the employee should die prematurely.

Executive bonus plan facts

	Employer	Key employee
Benefits	<ul style="list-style-type: none">• Income tax-deductible• Selects participants⁴• Can control the plan• No IRS approval needed• Easy to establish and administer• Key employee satisfaction• May limit key employee's access to the values²	<ul style="list-style-type: none">• Employer-paid cash value life insurance• Portable• Survivor benefits are income tax-free• May be able to access cash value with income tax-free withdrawals and loans, subject to restrictions, if applicable³• Income tax paid on premiums is less than cost of purchasing insurance separately
Considerations	<ul style="list-style-type: none">• After-tax cost of premium payments are removed from its balance sheet	<ul style="list-style-type: none">• Pays income tax on premiums; income tax rate may exceed employer's• Access to contract values may be restricted
Income tax impact	<ul style="list-style-type: none">• Premiums paid are tax-deductible as compensation, if reasonable	<ul style="list-style-type: none">• Premiums paid are taxable income
Gift tax impact	<ul style="list-style-type: none">• N/A	<ul style="list-style-type: none">• If policy is assigned, gift could be taxable
Estate tax impact	<ul style="list-style-type: none">• N/A	<ul style="list-style-type: none">• Includible in estate unless ownership is transferred 3 years prior to death

² The restricted premium plan is likely to be considered a split-dollar life insurance arrangement (SDA) under the final regulations. Although this type of arrangement would fall under the loan regime rules, because there is no reasonable likelihood of repayment, the transaction is subject to current taxation pursuant to the final regulations. You should consult your tax advisor regarding the possible tax impact of any planning considered to ensure it is appropriate for your personal situation.

³ Due to the Sarbanes-Oxley Act's prohibition on loans to officers of publicly traded companies, the BATL Plan[®] is not a suitable strategy for these businesses.

⁴ To avoid the major provisions of ERISA, the access to the value of the policy should not be tied to retirement and should be limited to a selected group of management and key employees.

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