

Executive Bonus



Presented to: Valued Client
Presented by: AIGAG Agent

Executive Bonus

Executive bonus (also referred to as an IRC Section 162 plan) is a fringe benefit which an employer can offer its key employees. This flexible arrangement enables an employer to provide select employees with the means to purchase and own life insurance policies.

For the Employer:

The employer outlay for premiums is tax-deductible where compensation is reasonable and the employer retains no ownership rights or beneficial interests in the policy.

The employer can be selective in favor of any employee.

The amount of life insurance coverage and the premium amount can be determined on an individual basis.

It can be easily installed and administered.

It can help attract and retain valuable employees by providing a substantial life insurance death benefit and the opportunity to access accumulating cash values in the future.*

Both can benefit from an executive bonus plan.

For the Employee:

The employee receives additional compensation in the form of premiums paid for the life insurance protection. His/her out-of-pocket outlay is limited to the taxes on this premium.

With a double bonus, the employee can generally have no out-of-pocket costs to participate.

Future life insurance policy cash values can be accessed through policy loans or withdrawals for any purpose, including college or retirement.*

Substantial life insurance protection can be provided for a variety of personal needs, e.g., protecting family income or for estate planning.

The employee controls the life insurance policy, including cash values, dividends and the right to name the beneficiary(ies).

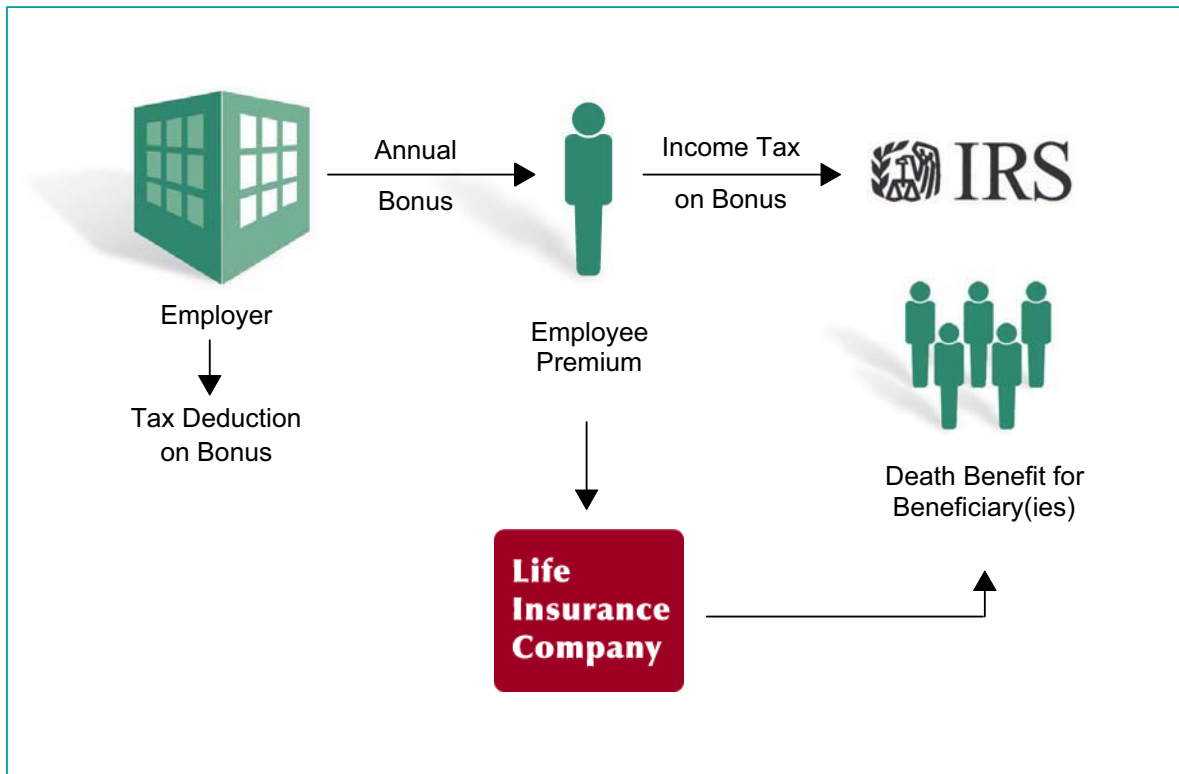
** Policy loans and withdrawals will reduce cash value and death benefit. Policy loans are subject to interest charges. If your policy is a modified endowment contract, loans and withdrawals may be subject to taxes and penalties.*



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How Executive Bonus Works ...

- The employer pays a cash bonus to the key employee and receives an income tax-deduction for the bonus paid.
- The employee uses the bonus money to purchase a life insurance policy. (In some cases the employer pays the premiums directly to the insurer.)
- The bonus amount is included in the employee's W-2 as additional income.
- The employee owns the life insurance policy, names the beneficiary(ies), and controls all rights to any available cash value accumulation, surrender values, and other policy benefits.
- The employer retains no ownership rights or beneficial interest in the policy.



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Assume the employee's tax bracket is 36% and that the life insurance premium is \$5,000...

Double Bonus:
 $\$5,000 / (1 - .36) = \$7,812$

Estimated Income Tax:
 $\$7,812 \times .36 = \$2,812$

Employee premium payment:
 $\$7,812 - \$2,812 = \$5,000$

The double bonus could be calculated to cover state income taxes, Social Security taxes, and any other amounts.

The Executive's Bonus

With an executive bonus plan, the employer has the option of paying

- 1) a "single" bonus—just the premium amount, or
- 2) a "double" or "grossed-up" bonus—the premium amount plus an additional amount to help cover the employee's tax on the bonus, or
- 3) a "specified" amount at its choosing, towards the premium.

The double bonus amount can be estimated as

$$\frac{\text{Premium}}{1 - \text{employee's income tax rate}}$$

Tax Considerations ...

- The bonus money (premium payment) is taxable income to the employee.
- The bonus money is tax-deductible to the employer, provided all compensation, including the bonus amount, is reasonable, and the employer retains no ownership rights or beneficial interest in the policy.
- The policy death benefit may be received by the beneficiary(ies) income tax-free.
- Policy cash value growth is tax-deferred.
- Policy loans and withdrawals up to basis may also be tax-favored.*

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Reasonable Compensation ...

"Reasonable" may be based in part on the following criteria ...

- The duties performed
- The size and operational success of the specific business
- The contribution of the employee to the success of the business
- The compensation standards of the industry in which the business operates

Uses of Executive Bonus ...

- To provide life insurance to selected key employees.
- To provide the opportunity for cash accumulation for the employee.
- To provide tax deductibility to the employer.
- To provide a benefit that is not subject to the contribution restrictions of the Internal Revenue Code for qualified pension or profit sharing plans.
- To provide a legitimate expense for an employer that has high retained earnings.

The executive bonus may not necessarily handcuff the employee to the employer because the employee owns and controls the life insurance policy. There is no restriction preventing the employee from departing with the policy. The employee has immediate access to any policy cash surrender values or other benefits.

Formalizing the Arrangement

Since executive bonus forms part of the employee's overall compensation package, it may be appropriate to include any terms of the benefit in an employment agreement. A formal board of directors' resolution may also be advisable.

Again, life insurance premiums, together with all other compensation, must be "reasonable."

Medical and financial underwriting requirements for the life insurance must also be met.

FOR MORE INFORMATION, CONTACT ELITE MARKETING GROUP

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