EXECUTIVE BONUS PLAN

Help protect your competitive edge

Not a bank or credit union deposit, obligation or guarantee	May lose value
Not FDIC or NCUA/NCUSIF insured	Not insured by any federal government agency

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Reward and retain valued executives

High-quality employees provide a competitive edge that can take your business to the next level. An **executive bonus plan** using life insurance can help you attract and retain your industry's top talent and stand out as an attractive employer.

Is an executive bonus plan right for your business?

Consider it if:

- ✓ **You want to attract and retain top talent.**
- ✓ **You have executives who need life insurance protection.**
- ✓ **You want flexibility to customize and choose who participates.**

What is an executive bonus plan?

An executive bonus plan (sometimes referred to as a "section 162" plan) is a company-paid life insurance policy for employees who are key to your company's future success. The employees receive life insurance coverage to help protect their families, and the company records the tax-deductible premiums as compensation or bonuses to the key executives.

How it works

The executive bonus plan solution

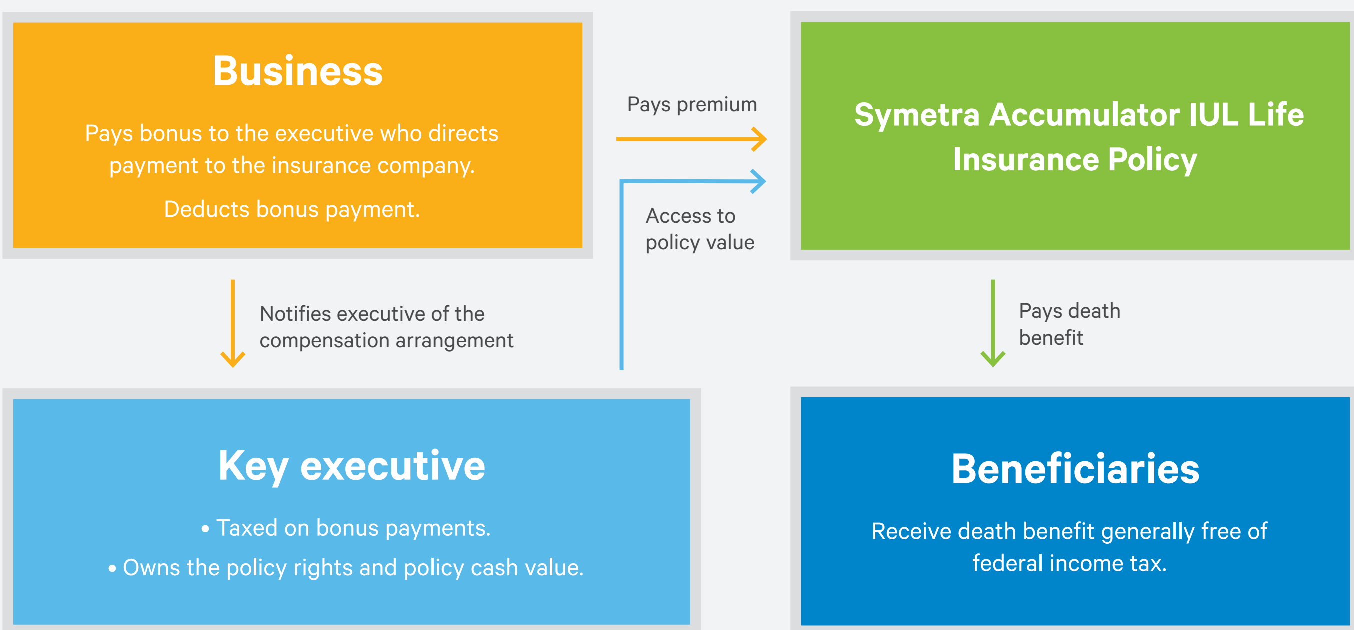
In an executive bonus plan:

1. The employer notifies the executive of its intention to provide a life insurance policy for the executive. The executive has full ownership rights to the policy and names the beneficiaries.

2. The employer pays a taxable bonus to the executive who directs payments to the insurance company for the premiums on the life insurance policy, and the executive's net cost is limited to the income tax due on the bonused amount. As an alternative, the employer can choose to cover the executive's costs with an additional cash bonus (sometimes referred to as a "grossed-up" or "double" bonus). The employer can deduct the bonused amount for that particular year and receive a tax savings.[1]

3. Subject to any arrangement with the employer, the executive may access the policy value of the life insurance policy through loans and withdrawals for supplemental income needs. Upon the death of the executive, the death benefit proceeds are paid to the executive's designated beneficiaries generally free of federal income tax.

How the strategy works



Access to supplemental retirement income through loans and withdrawals.[2]

Note: If the bonus plan is designed as a Restrictive Executive Bonus Arrangement (REBA), the executive would have restricted access to the policy value based on the terms and conditions of the executed agreement with the employer. Refer to the following pages for more information about REBAs.

[1] The deductibility of the executive bonus is subject to the reasonable compensation limits in Internal Revenue Code Section 162(a).

[2] Policy loans and withdrawals are only available prior to the death of the insured(s) and will reduce the policy death benefit and cash surrender value. This may cause the policy to lapse and may be taxable. Loans or withdrawals on modified endowment contracts (MECs) may be subject to federal income tax and an additional 10% tax on amounts taken prior to age 59½.

Restrictive executive bonus arrangements (REBAs)

Business owners looking for more control and executive incentives may consider implementing a "restrictive executive bonus arrangement" (REBA), which is simply an executive bonus plan with additional features to help create a "golden handcuff."

Restrictive endorsement
A restrictive endorsement—an agreement where the employer and key executive agree to certain terms and conditions for a specified period of time—is placed on the policy. Typically, the endorsement limits the executive's rights to access policy values through loans and withdrawals, surrender the policy, assign the policy as collateral and/or change the ownership of the policy without written consent from the employer. (See Modification of Ownership Rights form below.) However, as in an executive bonus plan, the executive owns the policy and has the right to name the beneficiaries.

Vesting and repayment schedule
A vesting and repayment schedule is established between the employer and executive that would require repayment of some or all of the bonuses if the executive leaves before the end of the vesting schedule. The vesting schedule can be flexible in design to encourage executives to remain with the company.

Implementing the plan

Executive bonus plan
An executive bonus plan is easy to implement, as the employer can pay a taxable bonus to the executive who directs payments to the insurance company for the premiums on the life insurance policy and report the bonus to the executive on Form W-2.

Additional restrictive executive bonus arrangement (REBA) steps:

1. **Agreement** – A REBA agreement providing the plan details should be executed between the employer and the key executive.[3]

2. **Modification of Ownership Rights form** – This form should be completed and submitted with the application for life insurance. The modification form restricts the executive from surrendering the policy, taking loans or withdrawals from the policy value, changing ownership of the policy and/or assigning the policy as collateral without the written consent of the employer. The restriction is applicable during the agreement period and will generally expire at the earlier of: (a) the insured's death, (b) bankruptcy, receivership, or dissolution of the employer, (c) termination of the insured's employment with the employer, and (d) a specified date in the agreement or written notification from the employer that the terms of the REBA have been satisfied.

Summary of documentation for implementation	Executive bonus plan	REBA plan
Life insurance application	Yes	Yes
Corporate resolution	Yes	Yes
Bonus agreement	No	Yes
Modification of Ownership Rights form	No	Yes

[3] A Restrictive Executive Bonus Arrangement (REBA) should be drafted by legal counsel and executed by both the employer and the executive.

Benefits

An executive bonus plan has numerous advantages for business owners and their most talented executives.

Business owners

Flexibility
Flexibility to customize and choose who participates, unlike the restrictions of traditional retirement plan benefits.

Simplicity
An easy-to-administer, cost-effective way to provide a valuable employee benefit, with no ERISA participation, reporting, or disclosure requirements and no administrative costs.

Tax deductibility
The plan is considered employee compensation, so it's tax deductible for the company with no IRS approval required.[4]

"Golden handcuff"
A restrictive executive bonus arrangement (REBA) provides incentives to help retain key executives with the use of a restrictive endorsement and vesting schedule.

Executives

Life insurance protection
More than just a bonus, the executives receive life insurance protection for their families. The designated beneficiaries receive a death benefit generally free of federal income taxes.

Tax-deferred growth
The potential policy value accumulation grows tax-deferred inside the life insurance policy.

Tax-advantaged income
As the owner of the policy, tax-free supplemental income may be attained through a combination of policy loans and withdrawals subject to any REBA limitations. But note that distributions from the policy will reduce the policy value and may reduce the death benefit payable to the beneficiaries.[5]

Ownership
If the employee leaves the company before retirement, subject to any REBA, the policy belongs to the employee, who assumes payment of any future and/or additional premium payments.

No IRS distribution requirements or additional tax[6]
Distributions from the policy are permitted before age 59½ with no additional tax, and there are no required minimum distributions (RMDs) at age 72 or later.

[4] The deductibility of the executive bonus is subject to the reasonable compensation limits in Internal Revenue Code Section 162(a).

[5] Refer to footnote 2.

[6] Only if the contract is not a MEC. Refer to footnote 2 for more information.

Key considerations

- **Premiums are not deductible by the executive**

  While the employer is paying the life insurance premiums, they are tax- deductible for the employer, not the executive. The employer can opt to cover the executive's tax costs with an additional cash bonus.

- **Ordinary income tax**

  Any bonus paid to the executive is taxable as ordinary income in the year paid. The bonus is also subject to Social Security (FICA) and Federal Unemployment Tax (FUTA).

- **Separation of employment**

  If the executive leaves the employer during the bonus arrangement period, the executive will be required to pay any ongoing premiums, if necessary, or the policy may lapse.

- **Limited rights to policy value**

  During a restrictive executive bonus arrangement (REBA) period, the policy will have a restrictive endorsement giving the employer control over many policy rights until the restriction expires or is released.

- **Limited cost recovery**

  Under a restrictive executive bonus arrangement (REBA), the employer has limited rights to the policy values and may not receive part or all of the death benefit as reimbursement for the after-tax cost of the bonus.

Is an executive bonus plan right for your business?

If you want to retain and attract top talent within your industry, have executives who need life insurance protection, and want the flexibility to customize and choose who participates, an executive bonus plan may be appropriate for your business.

Contact your insurance professional for more information.

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