Executive Bonus Plans

Life's Acknowledgements

Recruiting, retaining and rewarding key employees can be one of the toughest jobs you'll face as a business owner. Choosing the right benefit plan – one that doesn't come with cumbersome regulations or time-consuming administrative requirements – can be just as tough. Still, you want to do something special for the people who add value to your business – the people who, like you, have a stake in its success.

For many business owners, the answer is an insured Executive Bonus Plan, a selective employee fringe benefit.

What is an Executive Bonus Insurance Plan?

An Executive Bonus Insurance Plan (also referred to as a "Section 162 Plan") is a life insurance policy purchased by you, the employer, for the benefit of selected key employees. It allows you to use company dollars in the form of a "bonus" to pay for personal life insurance needs of key employees, which may include:

- Estate liquidity
- Family survivor income
- Supplemental retirement income
- Financial emergencies

It works this way:

Your company chooses the employee(s) who will participate in the plan, and determines the bonus amount that will be paid for policy premiums. The employee applies for, owns, and names beneficiary(ies) of the policy. The company pays the "bonus" premium directly to the insurance company. The employee's right to access policy cash values through loans, withdrawals, or surrender can be subject to a vesting schedule based on age, years of service, or other conditions agreed upon by the company and the employee. If the employee terminates employment prior to becoming fully vested, the company is repaid some or all of its "bonus" premiums from the policy's cash value.

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What are the advantages of an Executive Bonus Plan?

Advantages of an Executive Bonus Plan for you, the employer:

1. Its beneficial. Executive Bonus Plans provide an extra benefit to attract, retain or reward your key employees – including yourself.
2. It's cost-effective. All the premiums you pay are income tax-deductible.
3. It's selective. There are no mandatory eligibility and participation rules. You select which key employee(s) will participate in the plan and the coverage amounts for the individual life insurance policies.
4. It's flexible. There are no required plan provisions. Each policy can be custom-tailored to meet each participant's needs and objectives.
5. It's simple. There are no complex governmental documents or ERISA reporting procedures to follow, and a simple agreement between the employer and employee is all that's necessary to put the plan in effect.

Recruit, retain and reward your key employees with the right benefit plan.

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Advantages of an Executive Bonus Plan for you and your employees:

1. Tax benefit: Income tax-free death benefits for you and your employees.
2. Employee ownership: The life insurance policy is owned and controlled by your key employees.
3. Added value: Long-term life insurance protection which accumulates policy values and provides a choice of income options at retirement, disability or termination of employment. Other benefits include tax-deferred growth of cash values and the potential for income tax-free retirement income through policy loans and withdrawals.
4. Flexibility: Even though policy premiums paid by you are taxable to the employee, the tax impact can be greatly reduced using loans, withdrawals, or policy dividends (if any) paid directly to the employee, to offset the tax. In addition, the company can provide a tax-deductible "double bonus" to the employee, paying the tax as well as the premium.
5. Portability: Since your employee owns the policy, it can remain in force even if he or she leaves the company or upon retirement.

Please note: Certain limitations may apply to loans and withdrawals. Policy loans and withdrawals will reduce the death benefit and cash values and may be taxable under certain circumstances. We also assume that the policy purchased does not become a Modified Endowment Contract, as defined by the Internal Revenue Code. For specific questions about your personal situation, you should consult a qualified tax advisor.

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How do Executive Bonus Plans work?

Under an Executive Bonus Plan:

1. You select the employees to whom the plan will be offered.
2. You determine the amount of the benefit you want to provide to each employee. These amounts may vary from employee to employee.
3. The employee applies for the life insurance policy and names any beneficiary he or she chooses, provided it is not the employer.
4. The company pays policy premiums directly to the insurance company and the "bonus" premiums are treated as additional compensation to the employee.
5. The plan can be either "unrestricted" or "restricted".
   - Unrestricted: the employee has an immediate right to all policy cash values.
   - Restricted: the employee's right to access policy cash values through a loan, withdrawal, or surrender is subject to a vesting schedule based on age, years of service, or other conditions agreed upon by the company and the employee. If the employee terminates employment prior to becoming fully vested, or otherwise fails to satisfy the stated conditions, the company is repaid some or all of its "bonus" premiums (usually from the policy's cash value).
6. For each participating employee, you enter the appropriate information on payroll and personnel records.
7. The premium is included on the employee's W-2 form and on his or her individual income tax return. You calculate the employee's withholding tax, Social Security tax, etc., as if the premium were paid as additional cash compensation to the employee.

It's as easy as that.

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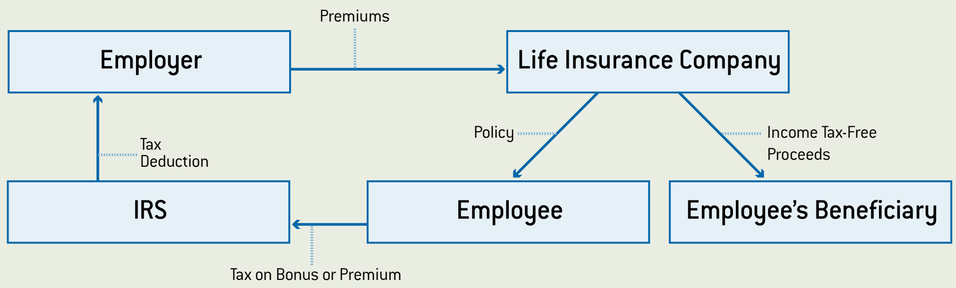
How Executive Bonus Plans Work



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What are some common uses of Executive Bonus Plans?

Executive Bonus Plans can help you and your key employees reach your financial objectives in a number of different ways.

In lieu of Salary Continuation Plans

Under a typical Salary Continuation Plan, you, the employer, own a life insurance policy on a key employee. When the employee dies, you receive the policy proceeds and pay them to the employee's beneficiary as part of the plan agreement. The problem with this arrangement is that although the policy proceeds are non-taxable to you, they are generally considered to be taxable to the employee's beneficiary.

In an Executive Bonus Plan, however, the life insurance policy

- Is owned and controlled by the employee.
- Provides a cash value. At retirement, the employee can take policy loans or withdrawals to provide supplemental retirement income.
- Provides an income tax-free death benefit to the employee's beneficiary.

What are the tax implications?

- The employee pays ordinary income tax on the amount of premiums you pay.
- Premium payments you make will be tax-deductible provided they do not constitute "unreasonable compensation" to the employee (IRC Section 162).

Cross-Purchase Buy-Sell Agreements

Executive Bonus Plans are also well-suited for funding Cross-Purchase Buy-Sell Agreements among the owners of the business. Because Cross-Purchase Buy-Sell Agreements generally involve multiple policies, funding them often gets expensive. An Executive Bonus Plan helps solve this problem because the company, not the key employee, pays premiums.

Here's how it works: You and the other owners set up a Cross-Purchase Buy-Sell Agreement, and each of you purchase a life insurance policy on the other owners. Under the Executive Bonus Agreement, the premiums for the policies are paid by the compant. When an owner dies, the proceeds are used to buy out the deceased owner's interest in the business.

What are the tax implications?

- You and the other owners are taxed as ordinary income on the amount of premiums you (the employer) pay.
- Premium payments you make will be tax-deductible provided they do not constitute "unreasonable compensation" to you and the other owners (IRC Section 162).

Group "Carve-Out" Plans

Under existing tax law, you are limited in the amount of group life insurance you can provide your key employees. A Group "Carve-Out" Plan essentially separates the life insurance coverage you provide to yourself and selected key employees from the coverage you provide to your other employees, and provides all or a portion of it through individual policies paid for with an Executive Bonus Plan. Key employees are literally "carved out" of the larger group.

Not only does the Executive Bonus Plan allow you to overcome the restrictions of group life insurance, but it can provide you and your key employees with increased long-term, cash value coverage during your employment, as well as post-retirement cash values and death benefits not generally available under group life plans.

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What are the tax implications of Executive Bonus Plans?

1. You treat any premium payments made as additional employee compensation, either as a salary increase or a bonus. You can deduct this extra amount from your federal income taxes as an ordinary business expense, as long as it does not constitute "unreasonable compensation" as defined by the Internal Revenue Service (IRC Sec. 162).
2. Your key employees report the premiums each year as additional, taxable compensation.
3. Taxes to the employee can be reduced in several ways:
   - Policy cash values can be withdrawn or borrowed from the policy to pay taxes.
   - The employer can provide an additional cash bonus to the employee, covering both the premiums and income taxes due.

Note: This information is not intended to be comprehensive legal advice on Executive Bonus Plans. You should obtain qualified tax counsel relative to your particular financial situation.

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