



# Executive Bonus

Agent reference guide



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# WHAT IS EXECUTIVE BONUS?

Executive bonus is the simplest of the executive benefit plans. In an effort to recruit, reward and/or retain top talent, the employer agrees to pay the premiums on a life insurance policy owned by the employee. Under an Executive Bonus arrangement, the employer pays a bonus each year to selected employees, typically either in cash or in the form of premiums on life insurance policies on the employees' lives. This is not the same as key employee insurance, which is intended to protect the business from losses resulting from the employee's death. Rather, it is employer-financed personal life insurance intended to benefit the selected employee. The employer is free to select the employees it wishes to benefit.

## HAVE YOU ASKED A BUSINESS OWNER ABOUT:

- Rewarding key employees?
- Ability to select whom they reward with no discrimination rules?
- A plan where all contributions could be tax deductible?
- Adding bells and whistles to their employee's retirement plans?
- Giving protection to employee's family in exchange for his/her loyalty to the company?

## BENEFITS TO THE EMPLOYEE

- Employee owns the policy, so it is portable if he or she terminates employment.
- The death benefit is income-tax-free.
- The employee's income tax liability for additional compensation can be met by borrowing or withdrawing policy cash values (with a reduction in death benefit and possible tax consequences) or receiving an additional bonus from the employer.
- The employee can use the cash value of the policy to, among other things, supplement retirement income (with a reduction in death benefit and possible tax consequences).

## BENEFITS TO THE EMPLOYER

- Salary or bonus used to pay premiums represents an ordinary and necessary business expense of the employer, and, to the extent compensation is "reasonable" in the aggregate, is tax-deductible under Section 162.
- The arrangement does not have to be prequalified by the IRS, nor is it subject to annual reporting and disclosure rules.
- There are no annual administrative costs.
- The employer may freely select the employee(s) it wishes to benefit and vary the benefit among the participating employees.

EMPLOYER



Employee and Employer are both looking for **efficient, cost-effective ways to:**

**Meet family financial needs**  
**Protect survivors**  
**Ensure a legacy**

EMPLOYEE



# PROSPECTS PROFILE



**Age:** Pre-retirement

**Income:** Highly compensated individual making the maximum contribution to the company's sponsored plans, like 401(k)s, or has restrictions on contributions due to higher annual income.

**Status In Company:** A valued employee who makes significant contributions. The company wants to reward the employee and give him or her extra incentives to remain. The company is concerned that the employee may leave the company, but also has experience that cannot be replaced. A prospect may be:

- Chief Executive Officer
- Chief Financial Officer
- Chief Marketing Officer
- President
- Member of the Board of Directors
- Executive Vice President
- Senior Vice President
- Vice President
- Highly Compensated Sales People

**Financial Security:** The employee is concerned that he or she will not have enough money in retirement to maintain the current standard of living. May also have a potential estate tax problem or cannot afford a life insurance policy.

**Marketing Opportunities:** Easy for employer to implement through a simple corporate resolution establishing the arrangement. Companies to market an Executive Bonus arrangement include:

- Tax pass-through business entities such as S corporations, limited liability companies and partnerships for both key employees and owner participants (however tax benefits in providing an Executive Bonus for an owner participant of a tax pass-through entity are negligible);
- Any closely held business with key employees;
- Family businesses or sole proprietorships with family members as employees;
- Small businesses where qualified plans are too expensive;
- Group term carve-out opportunities where additional insurance benefits are provided to a select group of employees “carved out” of a group term plan;
- Companies in a higher tax bracket than the employees where the combined tax paid can be reduced;
- Companies wishing to find a replacement for qualified plan benefits;
- Providing a premium source to fund a cross-purchase buy-sell between shareholders.

Almost any type of life insurance policy can be used as part of an Executive Benefit arrangement. However, selecting a product with excellent cash value growth potential combined with preferred policy loans can prove superior for supplemental income and death benefit coverage.



# HOW THE ARRANGEMENT WORKS

An Executive Bonus arrangement, also known as a Section 162 Bonus, can be used by an employer for the employee's purchase of life insurance. Generally, the employer pays the premium and that premium is included in the employee's yearly compensation. Alternatively, the employer could bonus cash to the employee who then uses the cash to pay the premium.

The employee usually applies for and owns the policy, naming someone other than the employer as beneficiary. The cash bonus or premium is declared as additional compensation on the employee's W-2. The annual taxes on this bonus are, in some cases, funded by an additional cash bonus to the employee, known as a double bonus.

Eventually, the policy's annual cash value increase will exceed the tax on the bonus and may be borrowed or withdrawn to pay taxes. Policy loans or withdrawals will, of course, reduce the death benefit and may have tax consequences.

The employer should be able to deduct the bonuses to pay premiums as an "ordinary and necessary" business expense under Internal Revenue Code ("IRC") § 162, assuming the employee's compensation is reasonable. These employer bonuses are wages and therefore subject to FICA and FUTA withholding. As with other life insurance, the death proceeds usually will be received income tax-free by the employee's personal beneficiary under IRC Sec. 101(a).





## HOW TO INSTALL AN EXECUTIVE BONUS ARRANGEMENT

- 1.) **Work with legal counsel to draft a legal agreement that describes the terms and conditions between employer and employee:**
  - a. *Will employer bonus additional money to cover income taxes related to payments of premiums?*
  - b. *What are the conditions upon which the employee's employment ends?*
  - c. *When are the bonus payments to be made?*
  - d. *What are the termination rights of each party?*
  - e. *Will the employer place any restrictions on the investment values?*
- 2.) **Select the appropriate Accordia Life insurance product to support the design and complete appropriate applications and underwriting**
- 3.) **Document in permanent records establishment of the agreement.**

# TYPES OF EXECUTIVE BONUS

## 1) SINGLE BONUS

Employer pays amount equal to premium payment. Employee pays income tax on amount paid. This is the simplest type of executive bonus. It benefits the employee by helping them pay for a life insurance policy; the employee is solely responsible for the income tax due on the premiums.

**EXAMPLE:** Employer pays annual premium of \$10,000. Employee pays the tax on the bonus. If the employee's combined tax rate is 40%, the employee has to pay \$4,000 in taxes ( $\$10,000 \times .40 = \$4,000$ ).

## 2) DOUBLE BONUS

Employer pays amount equal to premium payment plus pays an additional amount to cover the employee's income tax created by premium bonus. This arrangement gives the employee the double bonus of having life insurance premiums paid by his/her employer and not having to pay the income tax that is due on the premiums. It does increase the employee's income, but it results in the employee having a net-zero out of pocket cost while funding the policy.

**EXAMPLE:** Employer pays annual premium of \$10,000 plus a bonus to the employee of \$6,667 to pay the tax due. To find how much the double bonus would be, use following formula: premium divided by (1 minus the tax rate). If the employee's tax rate is 40%:  $\$10,000 / (1 - .40)$  or  $\$10,000 / .60 = \$16,667$ . So the employer would bonus \$16,667, since  $\$16,667 \times .40 = \$10,000$ .

## 3) POLICY PAYS INCOME TAX

Employer pays amount equal to premium payment. Employee uses policy withdrawals or policy loans to pay income tax due. This allows the employee to have a net-zero out of pocket cost while funding the premium. The trade-off, however, is by using a loan or withdrawal, the death benefit and cash value in the policy will be reduced.

**EXAMPLE:** Employer pays annual premium of \$10,000. If the tax is 40%:  $\$10,000 \times .40 = \$4,000$  the employee has to borrow from the policy. Employee takes a loan from the policy of \$4,000 to pay the tax on the bonus. (assuming adequate cash values)

# VARIATIONS

## **Restricted Executive Bonus Arrangement**

Although the employee is the owner of the policy, the employer may wish to place some restriction on it. For example, the employer may want to limit the employee's access to cash value of the policy or limit the ability to transfer ownership for a defined period of time. Also, employers may use certain restrictions as an incentive for the employee to stay with the employer to receive bonuses with which to pay premiums. The employer may be concerned that the employee may access the policy's values prematurely, compromising the long-term usefulness of the arrangement.

Therefore, some insurance companies allow the use of a restrictive endorsement to modify policy ownership rights. This endorsement restricts certain rights that would otherwise belong to the owner of the policy. Among these are the rights to surrender the contract, make a policy loan or pledge the contract as collateral, unless permitted to do so by the employer.

By using a restrictive endorsement, the employee can still unilaterally designate and change policy beneficiaries, but the written consent of the employer is required to exercise other ownership rights in the policy. The restrictive endorsement can be designed to expire at a defined point in the future, such as:

- A specified age attained by the employee
- The date at which the employee becomes fully vested in the policy cash values
- A change in business ownership

In addition to the restrictive endorsement, an employment contract is also sometimes used to "handcuff" the employee and provide a means for the employer to recover the bonus payments (to the extent the bonus amounts are not vested) if the employee terminates employment before the date specified in the contract. The employment contract is a separate legal agreement between the employer and employee. It is this agreement, not the policy endorsement filed with the insurance company, which allows the employer to recover the nonvested bonus amounts. The restrictive endorsement does not give the employer any access to the policy's cash value. Therefore, the recovery of unvested bonuses requires enforcement of the employment contract (which may include litigation in a court of law) in the event that an employee terminates employment prior to the date agreed upon in the employment contract.

# ADVANTAGES OF AN EXECUTIVE BONUS ARRANGEMENT

## **The employer benefits of providing an Executive Bonus arrangement include:**

- Reward selected key employees
- Each employee's benefit can differ (discrimination)
- Can determine the bonus amount from year to year for each employee individually
- Arrangement can be terminated without IRS approval
- Contributions are fully deductible if compensation is reasonable
- Arrangement is simple to implement and administer
- Builds loyalty with the employee and handcuffs him/her by restricting access to policy cash value (Modification of Ownership Rights form)

## **The employee also enjoys a number of distinct advantages through an Executive Bonus arrangement:**

- The arrangement can be designed to meet the specific individual needs of each employee
- Beneficiaries will generally receive the insurance death benefit income tax free
- Accumulating cash values inside the policy grow income tax deferred and can be available to the employee for retirement or other needs
- Retirement benefits could be increased through employee's additional voluntary premium payments
- Retirement benefits can be accessed income tax free through proper structuring and use of policy loans and/or withdrawals as long as the policy remains in force
- Employee owns the policy and is fully vested from the start of the arrangement

Employers need techniques to reward and retain key employees. In the current tax environment, Executive Bonus arrangements often make sense. Executive Bonus provides significant benefits to employee's while allowing those employee's to own and control the benefits. It offers a tax efficient vehicle for employee's to accumulate retirement funds, and provide post retirement life insurance coverage. Executive Bonus arrangements can also tie key employee's to the company - the longer the employee stays with the employer, the larger the benefit to the employee.

A blurred city street scene at sunset. The image shows a busy urban environment with tall buildings, including a prominent tower with a spire. The foreground is dominated by the out-of-focus legs and feet of people walking. A dark blue, trapezoidal text box is overlaid on the center of the image, containing white text. The overall atmosphere is one of motion and modernity.

We provide the products and support to bring it all together.



## About Accordia Life

Accordia Life is an innovative life insurance company, providing customers and agents proven expertise in indexed universal life insurance. The company's products help meet the protection, wealth transfer and small-business needs of customers throughout the United States. Accordia's success is built on a foundation of experience, exceptional products and deep relationships.

Accordia Life is a subsidiary of Global Atlantic Financial Group Limited, a multi-line insurance and reinsurance company with over \$30 billion in assets and 10 offices. Global Atlantic was founded at Goldman Sachs in 2004 and separated as an independent company in April of 2013.

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