Plan Overview

An Executive Bonus (or "162 Bonus") Plan is a type of benefit where additional compensation is paid by an employer to a key employee for payment of premiums on a life insurance policy. The key employee is typically both the owner and insured, and names a personal beneficiary. The policy is often designed to build cash value to help supplement retirement income via policy withdrawals and/or policy loans, in addition to providing financial protection for personal beneficiaries. The compensation for the premium payment is generally recognized as taxable income to the key employee in the year in which it is paid, and the employer may receive a corresponding tax deduction. The employer may sweeten the benefit by paying an additional "grossed up" bonus to help offset the potential tax cost to the key employee.

Potential Advantages for Employer

- Attractive benefit to recruit and retain key employees.
- Current income tax deduction for compensation paid to key employee.[1]
- Complete discretion in selecting which key employees to offer the benefit to as there are generally no non-discrimination requirements.
- Implementation and administration is generally easier compared to other forms of discriminatory benefit programs.
- Can enhance retention through additional "golden handcuffs" in the form of restrictive endorsements and repayment vesting schedules.
  - Restrictive endorsement give the employer the power to approve of or prevent the key employee from accessing policy values.
  - Repayment obligations allow employers to recover some or all of bonuses paid if the key employee separates from service within a defined period of time.[2]
- Provides an additional longer-term incentive component to employee's compensation package.

Potential Considerations for Employer

- Cost recovery not available in the event of premature separation from service by the key employee (unless a repayment obligation is in place).
- Employer has limited control over bonus after payment (unless a restrictive endorsement is in place).
- The asset (policy) is owned by the key employee and not on the employer's balance sheet.
- Key employee must be adequately insurable to participate.

1 For compensation to be deductible as an "ordinary and necessary" business expense, it must be considered a "reasonable" amount. IRC § 162(a)(1). Compensation paid to a "covered employee" of a publicly traded company in excess of $1 million may not be deductible. IRC § 162(m).
2 Any amounts repaid by the key employee may have to be recognized as taxable income by the employer if such amounts were deductible when originally paid.

Potential Advantages for Employee

- Cash values accumulate tax deferred and can be accessed income tax free.
- Access to cash values can also be done without pre-59 ½ early withdrawal penalties or requirement minimum distribution requirements at age 75.[3]
- Employees family may receive tax free death benefit protection at the key employee's death.[4]
- Policy can be protected from the reach of corporate creditors since it is personally-owned.
- Riders can be added that accelerate the death benefit income tax free in the event of chronic illness (possibly for an additional cost) which can help cover costs of care.[5]
- Premium payments are not subject to annual contribution limits applicable to qualified plans, Roth accounts, etc.[6]
- Policy can potentially be placed without medical underwriting through guaranteed issue (GI) if there are more than 10 insureds in the plan and carrier requirements are satisfied.

Potential Disadvantages for Employee

- Bonuses paid to the key employee are taxable income and may result in a tax cost to the employee.
    - Grossed up bonus by the employer can help mitigate this tax cost.
- If employee separates from service, he or she may be required to continue paying premiums personally.
    - May be required to repay some or all the prior bonuses if a repayment agreement was in effect.[7]
- Death benefit may be includible in the key employee-insured's taxable estate and subject to estate tax.
- Policy could require full financial and medical underwriting if the total number of insureds in the plan is insufficient.

[3] Withdrawals and policy loans from a life insurance policy remain income tax free if the policy stays in force until death and never becomes classified as a Modified Endowment Contract (MEC) under IRC § 7702A. IRC § 72.

[4] Death benefit proceeds received by way of the insured's death are generally income tax free. IRC § 101(a)(1). Death benefit proceeds can be taxable if the policy were transferred in exchange for valuable consideration during the insured's lifetime to another person that does not qualify for an exception to this rule. IRC § 101(a)(2).

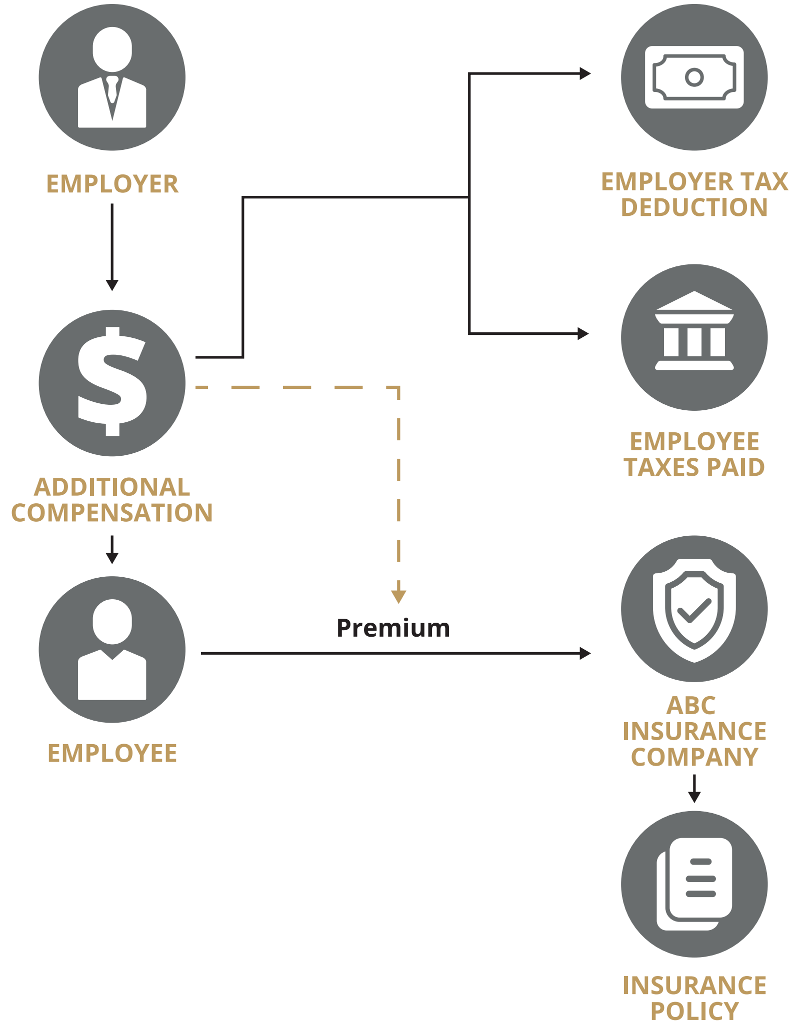
[5] For accelerated death benefit payments received during life to be income tax free, the acceleration must be due to the insured's chronic or terminal illness and be limited to the annual per diem limit prescribed by the IRS or the insured's qualified long-term care expenses, if greater. IRC §§ 101(g) and 7702B.

[6] Although no stated dollar contribution limits exist, aggregate premium limits apply per policy based on the face amount. IRC §§ 7702 and 7702A.

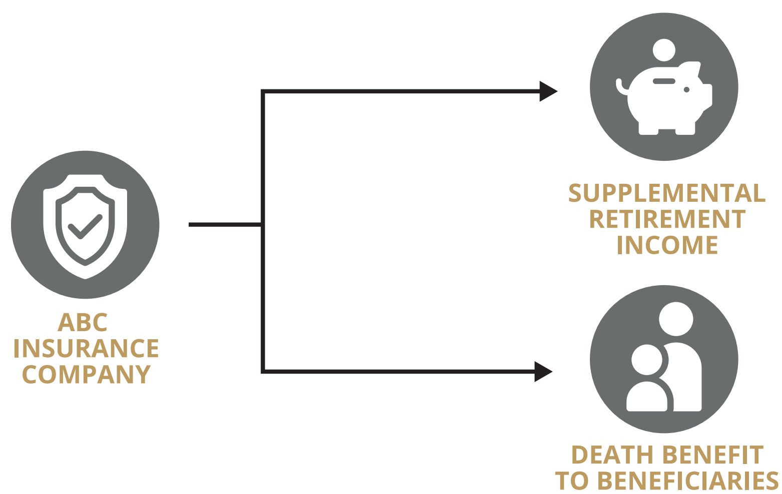
[7] Amounts of bonuses repaid may be deductible by the key employee as amounts restored under a claim of right if such amounts were taxable when originally received. IRC § 1341.

EXECUTIVE BONUS

During the Working Years



After the Working Years



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