DOLPH & ASSOCIATES
Insurance and Financial Services

Executive Bonus Arrangement

Overview

An executive bonus arrangement, also sometimes referred to as a "Section 162 Bonus Plan," is a benefit arrangement in which an employer pays bonus compensation to selected executives in the form of premium payments on the executives' personally owned life insurance policies. It is most easily described as employer-funded personal life insurance.

Situations

The executive bonus arrangement may be of particular interest to employers who desire to reward key executives with supplemental benefits without extending these additional benefits to all full-time employees as would be generally required under a qualified plan. It also may be of interest to employers who have qualified plans in place, but feel they need another benefit with which they can reward certain key executives.

Description & Operations

- Documentation Required: If there are no restrictions placed on the executive bonus arrangement, the only documentation needed is a corporate resolution adopted by the employer's board of directors. The resolution should establish the purpose for the bonus (for example, to help recruit, retain, and reward key executives). While it is not required, it may nevertheless be advisable for an attorney to formally document an agreement in writing between the employer and the executive that clearly defines the terms of the bonus arrangement.
- Executive Applies for Life Insurance: Typically, the executive both applies for and owns the permanent life insurance policy. As the owner of the policy, the executive has the right to name the beneficiaries of the policy's death benefit. However, the executive should not name the employer as beneficiary of the life insurance policy; otherwise the bonus would not be income tax deductible to the employer.
- Premium Payments: The employer may then either pay the premiums on the life insurance policy directly to the life insurance company or it may bonus the premiums to the executive, and the executive in turn writes the check to the insurance company. Sometimes, the employer will agree to pay an additional bonus amount to help the executive pay the income taxes on the bonus. This is referred to as a "double

bonus." In later years, the cash value of the permanent life insurance policy can possibly be accessed via policy loans or withdrawals to pay the additional income tax on the bonus amount, or for other needs. Note that loans and withdrawals will decrease the cash surrender value and death benefit.

Restricted Executive Bonus

If the employer desires to control when distributions can be made to the executive, a special endorsement may be placed on the life insurance policy which would require the employer's consent for the executive to: borrow cash values, surrender the policy, assign or pledge the policy as collateral for a loan, or change ownership of the policy. This endorsement would not give the employer any rights in the life insurance policy, other than the limited ability to participate in decisions that would affect how the policy is used during the time specified by the restriction. The executive would still be able to change the beneficiary.

The agreement between the parties would typically establish when the restrictions were scheduled to expire. Triggering events often include: the executive's retirement or disability, the attainment of a designated age, or when the employer discretionarily releases the restriction.

Once employment is terminated or once the restriction period otherwise expires, a written statement from the employer to the insurance company is required in order to remove the endorsement from the policy.

Tax Ramifications

Income Tax

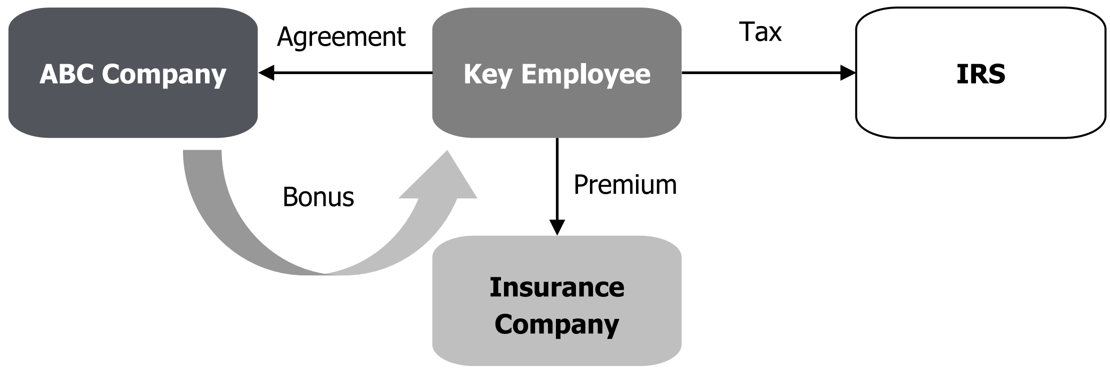
During life: The cash bonus or premiums paid by the employer will be reported as additional compensation on the executive's W-2 in the year in which the bonus is received. The compensation bonus is deductible by the employer in that same year, provided the executive's total compensation is a reasonable amount. Again, it is important to document the executive bonus arrangement via a corporate resolution in order to help establish the expense as a business expense of the company, thus helping preserve the tax deduction.

At death: At the executive's death, the life insurance death benefit proceeds are generally received by the executive's designated beneficiaries free of federal income taxes.

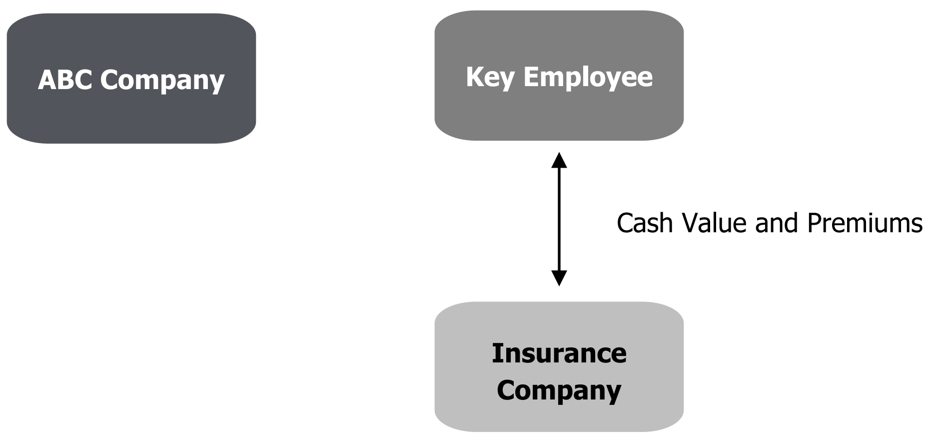
Estate Tax

If estate taxes are a concern for the executive, he or she may wish to establish an irrevocable life insurance trust (ILIT) to own the life insurance policy. However, if the policy is owned by an ILIT, gift tax issues will need to be addressed.

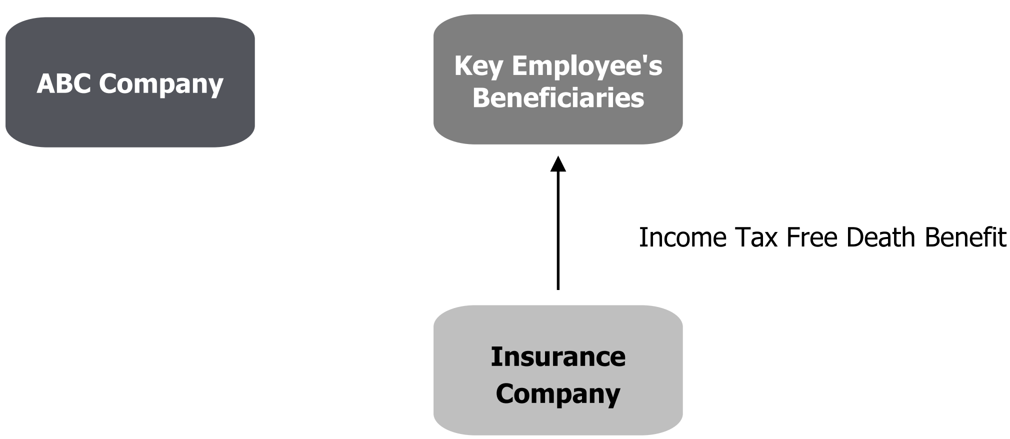
Executive Bonus Arrangement During Lifetime



Executive Bonus Arrangement After Retirement



Executive Bonus Arrangement At Death



Dolph & Associates
Insurance and Financial Services

Dolph & Associates, Inc.

Frank B. Dolph, III*

100 W. Cypress Creek Road, Suite 962, Ft Lauderdale, FL 33309
Phone: (954) 958-4239
fdolph@dolphandassociates.com

*Registered Representative offering securities through NYLIFE Securities LLC, Member FINRA/SIPC, a Licensed Insurance Agency, (100 W. Cypress Creek Road, Suite 962, Ft Lauderdale, FL 33309). Member Agent of The Nautilus Group®, a service of New York Life Insurance Company. Dolph & Associates, Inc. is not owned or operated by New York Life Insurance Company or its affiliates.

This tax-related discussion reflects an understanding of generally applicable rules and was prepared to assist in the promotion or marketing of the transactions or matters addressed. It is not intended (and cannot be used by any taxpayer) for the purpose of avoiding any IRS penalties that may be imposed upon the taxpayer. Dolph & Associates, Inc., New York Life Insurance Company, its agents and employees may not provide legal, tax or accounting advice. The arrangements described herein may be subject to the Employee Retirement Income Security Action of 1974, as amended (ERISA) and Internal Revenue Code Section 409A (Sec. 409A). ERISA imposes certain requirements on employee benefit plans and their sponsors, including but not limited to, fiduciary, disclosure and reporting requirements. These requirements depend on the type of plan. Sec. 409A imposes certain requirements that, if not satisfied, can result in adverse tax consequences to employees. Employers should consult with their legal and tax advisors regarding the implications of ERISA and Sec.409A on adopting these arrangements in their particular circumstances before implementing any planning strategies. Please consult your own professional advisors before making any decisions.