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Here’s to longer days, fresh perspectives, and continued progress ahead.

Partnering with you to help your clients plan with flexibility.
~ Tim, Mark, and Gayle

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Broker News

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Strategy Summary | Help Your Business Retain Key Employees

YOUR OPTIONS	EMPLOYER BENEFITS & TAX CONSIDERATIONS	EMPLOYEE BENEFITS & TAX CONSIDERATIONS	THINGS TO THINK ABOUT
Executive Bonus Plans (162 Bonus Plans) Funding vehicles include: – Life Insurance – Disability income insurance – Annuities A selective benefit	• Employer deducts bonus(es) paid. • Minimal administrative costs. • Minimal record keeping. • Ability to offer supplemental retirement benefits to key employees. • Employer can utilize a leveraged bonus concept for more control over policy.	• Flexibility as to what type of funding vehicle is used within the plan. • Values of a life insurance¹ policy or annuity can be used to help supplement or provide retirement income. • A life insurance policy will pay benefits to the employee's beneficiaries at death OR a disability income insurance policy will provide income to the employee in the event of disability. • Employee pays income tax on bonus(es) received.	• Who are your top employees that you would want to offer this type of benefit to? • Do you currently offer a supplemental incentive plan for your top employees? • Would you like to provide the option for the employee to retain coverage if he/she leaves your company? • Would you like the option to have multiple funding vehicles?
Non-qualified Deferred Compensation Plans A selective benefit	• Depending on the structure of the plan and how benefits are paid, the life insurance policy's proceeds or cash value can be used to recover the cost of the plan for the employer and pay a benefit to the employee's beneficiaries in the event of death. • Employer premiums are not deductible, but insurance proceeds received at death are income tax-free. (AMT considerations for C-Corps.)	• At retirement, the employee is eligible to receive income taxable supplemental retirement income from the employer. • If the employee dies, the employer pays the employee's beneficiary an income taxable survivor benefit.	• Who are your top employees that you would want to offer this type of benefit to? • Is the option to replace a key employee within this type of program, if he/she leaves the company, important to you? • Do you want to provide a benefit to your employees, but still control the asset?
Split Dollar Plans (Non-equity) A selective benefit	• Employer owns cash values. • Employer receives greater of cash values or premiums paid at death or termination.	• Employee's family receives death benefit in excess of cash value income tax-free. • Employee reports income on small economic benefits costs each year.	• Who are your top employee(s) that you would want to offer this type of benefit to? • Do you want to provide a benefit to your employees, but still control the asset?
Individual disability income insurance A selective benefit	• Employer gives employees opportunity to obtain discounted individual disability income insurance coverage, a sought-after and meaningful benefit. • Should an employer pay all, or some, of the costs, generally speaking, the premiums paid are tax deductible.	• Employees receive individual disability income insurance coverage at discounted rates. • If employees pay premiums for coverage, benefits received are generally tax free. • Employees may be able to protect their ability to continue saving for retirement if disabled.	• How would your company be affected if an employee or key person suffered a long-term disability? • What effects would a long-term disability have on an employee and their family/loved ones?
Personal financial planning services* A selective benefit	• Goodwill with key executives. • Potential for a more financially sound key executive population. • Employer may be able to deduct the cost of employee financial planning-related services.	• The employer may cover the cost of financial planning services. • Employee feels that employer cares about his/her financial well-being.	• If your company currently provides an employee benefit package which includes, for example, health insurance, and/or Group LTD, would your employees appreciate the opportunity to discover ways to enhance and supplement current company offerings? • Do you have key employees you want to provide this service to?



Scan this QR Code for Resource
Be a Finder and a Keeper -
How to Attract and Retain
Key Employees

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Distributions under the policy (including cash dividends and partial/full surrenders) are not subject to taxation up to the amount paid into the policy (cost basis). If the policy is a Modified Endowment Contract, policy loans and/or distributions are taxable to the extent of gain and are subject to a 10% tax penalty. Access to cash values through borrowing or partial surrenders will reduce the policy's cash value and death benefit, increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.
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Case Scenario

Celeste is the owner of Wayland Construction, Inc. She is planning to retire in a few years, and her son Jack will take over the operation of the company.

Steve is the lead project manager for Wayland Construction. He has been a major contributor to the success of the company. He is 50 years old and in excellent health. Celeste wants to ensure that Steve will stay with Wayland to help Jack run the company.

Their Goals

- Provide Steve with an additional incentive to stay with the company and reward him for his contribution to the company’s success.
- The benefit should have little to no cost to Steve.
- The benefit should be easy to understand and administer.
- Keep annual costs within budget and tax-deductible to the business.

A Possible Solution

Celeste explains the situation to her financial professional. At their next meeting, Celeste’s financial professional proposes an executive bonus arrangement for Steve. He reviews four design options with Celeste and explains how each could help meet her objectives.

OPTION 1: THE BASIC EXECUTIVE BONUS ARRANGEMENT (SINGLE BONUS)

Celeste’s financial professional shows her how a simple bonus arrangement would work:

- Wayland Construction will enter into a single bonus agreement with Steve to pay the annual premium on a \$500,000 whole life insurance policy on his life, until he retires at age 65 when the policy becomes fully paid-up. The annual premium for the policy is approximately \$20,000.
- Steve will be the owner of the policy and will name the policy beneficiary.
- Steve will pay income taxes on the premium bonus each year equal to \$6,600, assuming he is in the 33% marginal tax bracket.
- The company will be able to deduct from its taxes the premium bonus of \$20,000 each year compensation to Steve.

Celeste liked this option, and it was well within her budget. But she did not want the plan to cost Steve almost \$6,600 in taxes each year. Celeste’s financial professional understood and showed her an alternative approach that would address her concern:

OPTION 2: THE DOUBLE BONUS ARRANGEMENT

A double bonus arrangement works just like the single bonus. Wayland will pay premiums, and Steve will be responsible for paying the taxes. But under this arrangement, Wayland will pay an additional “grossed-up” bonus to Steve to cover the taxes due. The result will be an arrangement with no out-of-pocket cost to Steve. The additional (grossed-up) bonus will be \$9,851 (\$6,600 plus taxes @33%), so the total cost of the plan will be \$29,851.

Celeste liked this option also, but she did not think it did enough to “tie” Steve to the company for any length of time. Celeste’s financial professional explained how the third option may help resolve both of these issues.

OPTION 3: THE RESTRICTED EXECUTIVE BONUS ARRANGEMENT (REBA)

A restricted bonus arrangement is also set up like the basic bonus arrangement. When the agreement between Wayland and Steve is drawn up, a provision is added to the policy that requires the addition of a restrictive endorsement for a specified period of time which will generally limit the executive’s ability to:

- Surrender the policy for its cash value.
- Access the cash value of the policy through surrenders or loans.¹
- Collaterally assign the policy.
- Change ownership of the policy.
- Change the dividend option.

Wayland will pay the premiums and Steve is responsible for the taxes. The company will be able to take a tax deduction of the \$20,000 premium bonus as it is considered as compensation to Steve. It is important to note that these restrictions only limit the executive’s ability to exercise certain policy ownership rights for a limited period of time. They do not give the business a direct interest in the policy nor the right to recover any part of the plan cost from the policy.

OPTION 4: THE LEVERAGED BONUS ARRANGEMENT

A leveraged bonus arrangement is also set up like a single bonus option. Wayland pays the annual premium of \$20,000, and Steve is liable for \$6,600 in taxes. However, instead of Steve paying the taxes out-of-pocket, Wayland will loan him the \$6,600 each year, plus accrue interest on the loan. The total annual outlay for the arrangement will be \$26,600. The loan to Steve will be secured by a collateral assignment of the policy to Wayland.

The agreement will also stipulate that Steve will be required to repay all or a portion of the loan if he leaves the company or dies before completing 10 years of service. If either event occurs, the collateral assignment of the policy gives Wayland the right to recover the amount of the loan repayment directly from the policy. If Steve stays with the company for 10 years, Wayland may forgive the loan when he terminates employment with the company. The amount of the loan forgiven will be taxable as income to Steve at that time.* He may choose to pay the taxes out of pocket, or Steve could use partial surrenders and/or loans to pay all or part of the taxes due.

The Benefits to Wayland Construction

- A leveraged bonus arrangement is an **effective** retention tool that provides **benefits** over and above the standard compensation package
- The plan creates a strong incentive for Steve to remain with the company for the next 10 years.
- There are some important regulatory requirements that need to be met, but in general implementation and administration expenses are **minimal**.
- The premium payments provide an immediate income **tax deduction** to Wayland Construction, and the amount of any loan forgiven* will be deductible as compensation to Steve if he terminates employment with the company.
- Wayland may **recover** all or part of the loan from the policy if Steve leaves the company or dies before completing 10 years of service.

The Benefits to Steve

- The policy **death benefit**, net of any loan repayment to the company, will be paid **income tax free** to the beneficiaries.
- The policy **cash value** accrues **tax deferred**, and following the settlement of the loan and release of the collateral assignment, Steve may access the policy cash value during retirement on a **tax-advantaged** basis to supplement his retirement income.¹
- **Policy values** may be used to help repay the loan or pay taxes due if the loan is forgiven.

With the help of her financial professional, Celeste has four solid options to consider in order to meet the goals that both she and Steve have. By putting an executive bonus arrangement in place to reward and retain him, she will ensure the success of her company for years to come.



SCAN FOR
**Single Bonus
Arrangement
Example**



SCAN FOR
**Double Bonus
Arrangement
Example**



SCAN FOR
**Restricted Executive
Bonus Arrangement
Example**



SCAN FOR
**Leveraged Bonus
Arrangement
Example**

***Important taxation and regulatory considerations:** If a leveraged bonus arrangement is illustrated with loan forgiveness by the business, it is likely to be classified as a deferred compensation plan and subject to the requirements of Internal Revenue Code Section 409A. **In addition, if this plan is classified as a Deferred Compensation plan, ERISA filing and other legal requirements will apply.** Any promise (express or implied by facts and circumstances or patterns of practice, for example) by the business to transfer cash value to the executive upon termination of the loan agreement is a form of Deferred Compensation subject to Section 409A. Section 409A requires a written plan document and limits the circumstances for triggering the receipt of benefits (for example a provision allowing the participant to accelerate retirement benefits is generally not allowed). If the requirements of Section 409A are not met, the participant may be subject to less favorable tax treatment including substantial tax penalties. The rules under Section 409A are complex. The executive should be encouraged to consult with their independent tax counsel or advisor.

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¹ Distributions under the policy (including cash dividends and partial/full surrenders) are not subject to taxation up to the amount paid into the policy (cost basis). If the policy is a Modified Endowment Contract, policy loans and/or distributions are taxable to the extent of gain and are subject to a 10% tax penalty.

Access to cash values through borrowing or partial surrenders will reduce the policy’s cash value and death benefit, increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.

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