ADVANCED PLANNING

BUSINESS STRATEGIES

Executive Bonus Arrangements

THE CHALLENGE

Your employees make important contributions to your business. Some key employees may have unique skills and abilities that are critical to the continued success of your organization. Do you worry that they will be lured away by a competing company? Are you concerned that their current benefits package may not be enough to keep them working for your company? Or is there an employee at a competing firm whom you would like to have working for you?

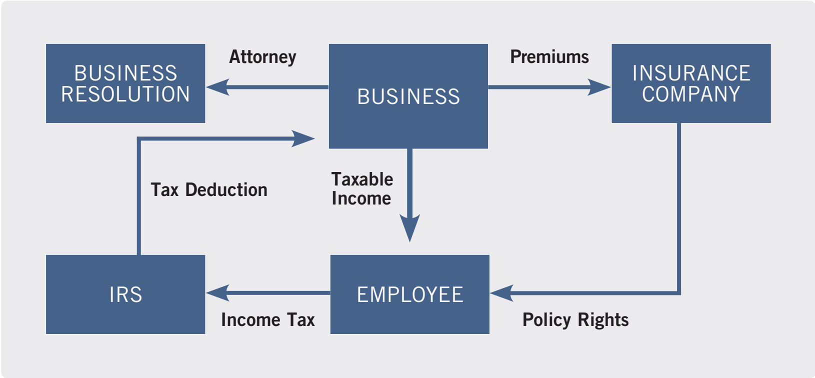
THE SOLUTION

One solution to attracting and retaining quality employees may be an **executive bonus arrangement.**

An executive bonus or a restrictive executive bonus arrangement is a way for you to provide needed life insurance to a key employee and receive an income tax deduction for doing so.

A well-designed executive bonus arrangement can have benefits for both the employee and the employer. Although the premiums paid by the employer are taxable to the key employee, the company can pay a double bonus to cover the employee's income tax liability. Alternatively, the employee can access the policy values to pay the tax.* The employee has full policy ownership rights, including the right to any policy values, the right to name a personal beneficiary, and the right to name a third party, such as a trust, as policyowner.

HOW AN EXECUTIVE BONUS STRATEGY WORKS



Typically, a business resolution is drafted by an attorney and adopted by the business, which notifies the participants of its intention to establish an executive bonus arrangement.

- The business may decide to pay the premium directly to the insurance company or the business may pay a taxable bonus to the key employee, who then pays premiums to the insurance company for a policy he or she generally owns.
- The business will include the bonus amount as taxable income to the employee for the current year.
- The key employee reports the bonus as income and remits the appropriate income tax to the IRS.
- The business receives a tax deduction in the year the bonus is included in the key employee's income.
- The key employee, typically, has full policy ownership rights, including the right to any policy values, the right to name a personal beneficiary, and the right to name a third party, such as a trust, as policyowner.
- **If life insurance is provided:** When the employee dies, the policy proceeds are paid to the named beneficiary, usually a family member. Or, when the employee retires, policy cash values can be used to supplement his or her retirement income.

* Outstanding loans and withdrawals will reduce policy cash values and the death benefit and may have tax consequences.

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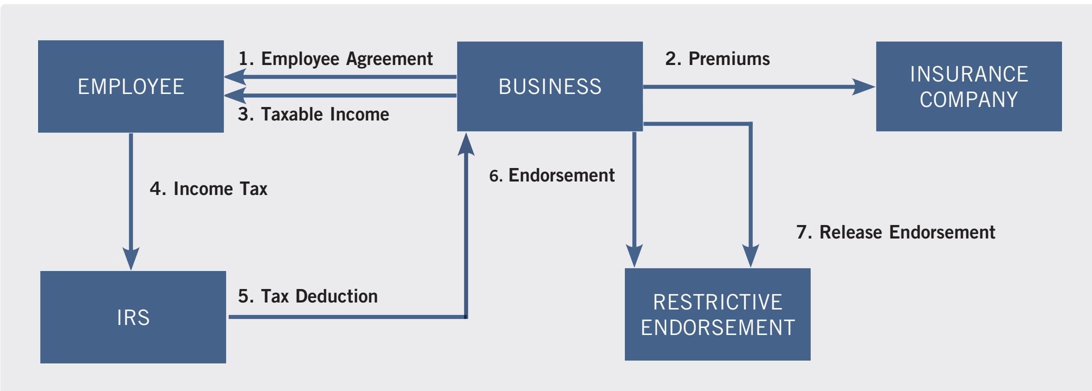
Prudential

A restrictive executive bonus arrangement (also referred to as REBA) is a way for an employer to provide needed life insurance to a selected key employee.

An employer may provide life insurance to a key employee on a tax-deductible basis while restricting the employee's access to the policy cash value. Although the employee (or his or her trust) owns the policy, when the policy is issued, a restrictive endorsement is placed on the policy that limits access to policy values. The premiums paid by the employer are taxable to the key employee, but the company can pay a double bonus to cover the employee's income tax liability. The arrangement acts as "golden handcuffs" to encourage the key employee to stay with the employer.

HOW A RESTRICTIVE EXECUTIVE BONUS STRATEGY WORKS



BENEFITS TO THE BUSINESS

- The employer is able to select the employees it wishes to include and can offer individual arrangements designed to meet the needs of the business and each employee. Bonus amounts and benefits may vary among participants.
- The arrangement typically requires minimal administration and associated costs and does not require IRS approval or complicated government reporting.
- Plan costs are deductible if total compensation to the employee is reasonable.
- **REBA ONLY** The restrictive executive bonus arrangements (REBA) endorsement can serve as "limited golden handcuffs," in effect tying a key employee to the business.

BENEFITS TO THE EMPLOYEE

- The employee is able to purchase life insurance at a lower out-of-pocket cost than if he or she were to purchase the insurance on his or her own.
- The employee is the owner of the policy with the right to name a personal beneficiary. The employee is also completely free to name a third party, such as a trust, as the policyowner.
- The policy is portable and can provide benefits before and after retirement. At the death of the employee, policy proceeds can help to replace lost income to the family, liquidate debts, and/or pay taxes and final expenses.

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HOW TO IMPLEMENT

- The employer identifies the key employees to participate in the arrangement.
- The attorney for the business drafts the resolution and employment agreement to establish the plan.
- The appropriate life insurance face amount and type of policy are determined.
- The employee applies for the life insurance and completes all medical and underwriting requirements.

REBA ONLY

- In conjunction with the purchase of the life insurance policy, a restrictive executive bonus arrangements (REBA) endorsement is placed on the policy that restricts the employee's access to the policy values but gives the employee the right to name and change the beneficiary and receive all of the death proceeds.
- Product: life insurance.

TAX CONSIDERATIONS

- The bonus, whether paid in cash or premium payments, is considered compensation and is generally tax-deductible subject to the limits under Section 162 of the Internal Revenue Code (IRC). The bonus is subject to payroll taxes and withholding and must be reported on the employee's Form W-2.
- The employee must pay income tax on the bonus. However, your business may provide an additional bonus to the employee to make up for the income-tax payments. This is called a "double bonus" and provides enough cash to cover both the insurance premiums and the employee's income tax on the bonus. This approach effectively eliminates any out-of-pocket expense for the key employee.

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