LIFE INSURANCE

EXECUTIVE BONUS

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Executive Bonus Life Insurance

You've found the perfect person for an executive position in your business. Now, how do you put together a compensation package attractive enough to close the deal, but that isn't too hard on your bottom line?

What is Executive Bonus Life Insurance?

A bonus to an employee is an efficient method of paying premiums for needed life insurance. The bonus is taxable compensation to the employee and is a normal deductible business expense under Section 162 of the Internal Revenue Code. Since it is treated as compensation, the life insurance premiums become tax deductible by the employer.

The arrangement also enables you to recognize valuable employees. A bonus in the form of premiums for life insurance protection shows that you really care for the welfare of your employees and their families. Using this concept can help meet several needs, including:

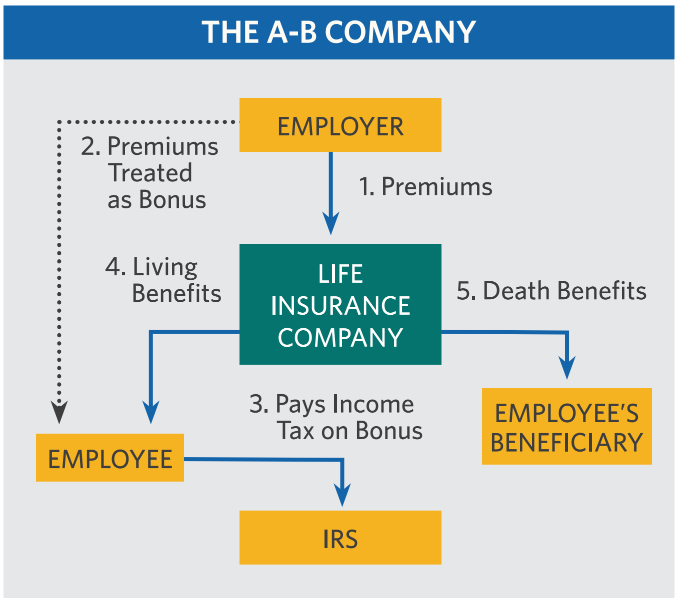
- Family survivor income
- College education funding
- Estate liquidity
- Supplemental retirement

How it Works

An executive bonus plan is easy to implement, as the employer can pay a taxable bonus to the employee who directs payments to the insurance company for the premiums on the life insurance policy and report the bonus to the employee on Form W-2.

1. The employer pays life insurance premiums directly to the life insurance company.
2. The premiums are treated as taxable compensation (bonus) to the employee.
3. The employee pays income tax on the bonus (premiums).
4. The employee retains full rights to the policy, including accessing the policy's cash values, pledging the policy as collateral for a loan and naming a beneficiary.
5. The death benefits are income tax free* when paid to a named beneficiary.

*Under current federal income tax law.



Executive Bonus Life Insurance Advantages and Tax Considerations

Advantages to the Employer

- No IRS approval is required
- The arrangement requires minimal ongoing administration
- You can be selective as to whom and how much to benefit an employee
- The arrangement can be an incentive for the key employee

Tax Considerations for the Employer

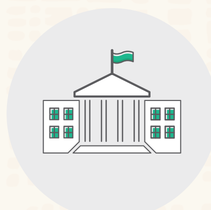
- The life insurance premiums are deductible as taxable compensation to the employee, as long as the compensation is reasonable
- If the bonus is paid to an owner of the business, the deductibility may vary based on how the business is organized
- A bonus is considered taxable wages for both FICA and FUTA purposes

Advantages to the Participating Employee

- The employee has full control of the life insurance policy
- The employee names a beneficiary of the policy's proceeds
- The employee benefits from using the business' dollars to pay for personally owned life insurance
- The employer can "gross up" the bonus to cover any income or FICA tax

Tax Considerations for the Participating Employee*

- Life insurance cash values accumulate tax free
- The beneficiary receives life insurance death benefits income tax free**
- The employee's cost is the income and FICA tax due on the "bonus"



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**Death benefit proceeds from a life insurance policy are generally not included in the gross income of the taxpayer/beneficiary (Internal Revenue Code Section 101(a)(1)). There are certain exceptions to this general rule including policies that were transferred for valuable consideration (IRC §101(a)(2)). This information should not be construed as tax or legal advice. Consult with your tax or legal professional for details and guidelines specific to your situation.

Restrictive Executive Bonus Arrangements (REBAs)

REBAs are similar to regular executive bonus arrangements, but offer more options to the business owner in terms of managing the agreement.

Key REBA Takeaways

1. REBA should be considered when an employer is wanting to establish boundaries that can be set on several aspects of the arrangement, particularly in regards to accessing the cash value of the policy. REBAs often give the employer more control over how and when cash value can be accessed. This can be for a specified period of time or until other agreed upon conditions are met.

2. When exploring a REBA scenario through Mutual of Omaha, there is a Modification of Ownership Rights form that needs to be completed. This form will determine any conditions the employer and employee agree upon in writing.

3. Any business owner looking to establish a REBA should work with an attorney to ensure they do not fall under IRS section 409A, which could impact the arrangement if a vesting schedule is used. Contact Advanced Markets for more information.

Key Questions:

- How do you reward your key employees?
- Would you like to get a current deduction for benefits provided to your key employees?

The purpose of this material is to illustrate a concept. Specific tax or legal questions should be directed to your tax or legal counsel.

Why Mutual of Omaha

Over 50 years of Mutual of Omaha's Wild Kingdom taught us that the animal kingdom and the human kingdom have something in common … an instinct to protect what matters most. Through insurance and financial products, we help people protect their lives, protect their families, protect their kingdoms.

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