

Business planning

Executive bonus arrangement (IRC 162 bonus)

The concept

An employer recruits and/or rewards employees by providing a bonus for the purpose of paying the premiums on a life insurance policy.

Benefits

This concept is the simplest type of employee benefit to establish and administer. It is an effective tool for recruiting and rewarding valued employees. Note that because the policy is completely portable for the employee, it does not serve as an effective tool for retaining employees. If more of a “golden handcuff” is preferred, a restricted executive bonus arrangement should be considered.

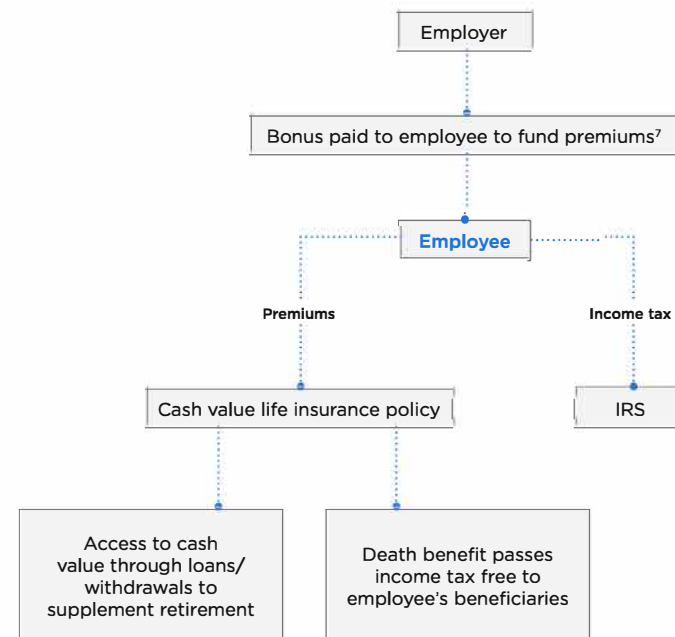
Tax considerations

- The employer’s premium contributions are taxable as ordinary income to the employee and are deductible by the employer under IRC Section 162, provided that the total amount of compensation to the employee is “reasonable”
- The death proceeds are paid income tax free to the employee’s beneficiary

Steps

- The employer agrees to pay the premiums on a life insurance policy purchased and owned by the employee
- The employee pays income tax on the additional income received either from additional bonus funds earmarked for this purpose or from other funds
- The employee has complete control of the policy, meaning that the employee can name and change the beneficiaries, take withdrawals from the policy and make loans against the policy

How it works



⁷ It is considered a double or budget bonus if income tax due on the bonus is being accounted for.