

Advanced Planning: Executive Bonus basics, designs and ways to use

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Presenter: Hello everyone, and welcome to another AuguStar Financial podcast. I'm Jim Barbee with Advanced Planning, and today I'm going to cover the number one fringe benefit we see, executive bonus. The basics of executive bonus, the four different designs, how it can be used to benefit both employers and employees, and how you can use advanced planning to incorporate executive bonus sales into your practice.

Let's start with the basics. What is an executive bonus? Well, an executive bonus, also referred to as a 162 plan, comes about through IRS code section 162, which permits employers to take reasonable deductions for expenses incurred generating a profit.

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Payroll is one of those expenses. So how does payroll work with life insurance? Well, in this case, the employee will be the owner of a life insurance policy on his or her life and choose the beneficiary.

The employer will pay the premium as part of the employee's compensation. The employer gets to take a deduction for the premium payment, as long as it's a reasonable amount and the employee is taxed on the premium amount. What is reasonable? Some agents ask me, well, if the employee is paid \$30,000 in compensation, a \$50,000 premium is probably not reasonable.

Unfortunately, the IRS hasn't given us any bright line rules on this.

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Now, you may have a situation where the employee says, this is great, I need the insurance, but I can't afford the additional tax burden. So, let's discuss a double bonus. In a double bonus scenario, the employer will pay the premium amount and also give the employee an additional cash bonus to cover the taxes on the premium, as well as the taxes on the taxes.

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And there's a simple math equation that we can show you how to use. This will benefit the employer by getting to deduct not only the premium, but the additional cash bonus. And it benefits the employee because the employee now doesn't have to come out of pocket for anything and enjoys the benefits of the life insurance policy. You will sometimes have cases where the employer says, well, this sounds great, but what's to stop the employee from leaving three years into this plan?

And the short answer is nothing. The employer paid for the premium. This was compensation to the employee. And the life insurance policy is really the employee's

property. However, we can use what's called a custodial restriction on the policy. In this arrangement, the employee voluntarily relinquishes the right to touch the cash value for a certain period of time or until a certain age.

So, the employee is free to leave and take the policy with them. However, if they do so, they're going to be required to continue paying the premiums or let the policy lapse, but they'll be restricted from touching the cash value under the terms of the original agreement. This provides an additional incentive for the employee to stay employed with the employer.

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Now, sometimes the employee will say, this is a great situation, but I actually need more life insurance than the employer is willing to offer. So now let's discuss contributory bonus. In this scenario, the employer will pay part of the premium and the employee will pay the other part. So, let's take a \$5,000 premium example. The employer pays \$3,000 of the premium, and the employee pays \$2,000 for a total \$5,000 premium.

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The employer deducts \$3,000 of the premium that it paid, and the employee is taxed on \$3,000. The employee is not taxed on the other \$2,000 that he or she contributed. All of these designs can work together and serve to reward, retain, and recruit valuable employees.

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How can you use advance planning to further these designs? Well, for starters, we have one page fliers, client approved on all of these four concepts. We have an extensive advisor guide on these concepts. We also have specimen documents. So, the executive bonus and custodial restriction require a contract. And we have a template for that, for you to provide to your clients and for them to work with their attorneys to put this in place. We also have custom reports. So after we come up with the nice illustration on the case, we can turn that into a custom report in our department that goes through all of the policy specifics, as well as tax consequences to both the employer and the employee in those custom reports are also some of the specimen documents that I mentioned.

I hope you've enjoyed this podcast. For more specific questions on Executive Bonus, please give us a call and call us with any other advanced planning case. We're here to help. Thanks for tuning in today.

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