An educational guide for business owners

Guardian®

Executive Bonus Plans

A strategy to help business owners attract and retain top talent

You know how difficult it can be...

to attract top performers to your business.

And once you do, today's competitive labor market can make it just as challenging to keep those talented employees on your staff. For these individuals, compensation is about much more than salary. Top performers commonly look for the kind of incentives that will provide them with the financial rewards they feel they deserve.

Many employers believe they've done enough by offering standard benefit plans, such as a 401(k) with a generous match. But top executives often require much more. If you're looking to offer a versatile, cost-effective executive benefits program for just your top talent, an Executive Bonus Plan can help you satisfy the financial expectations of key employees and foster their loyalty at the same time.

What is an Executive Bonus Plan?

A basic Executive Bonus Plan is very simple. The employee purchases a life insurance policy on his/her life, and the employer pays the premium (i.e., the "bonus"). The employer is eligible to take an income tax deduction on the bonus if the bonus is considered reasonable compensation,[1] and the employee pays the taxes on the bonus.[2] In some cases, the employer even pays the taxes for the employee through what is called a "double bonus." The employee has full access to the policy cash value and the valuable income tax-free death benefit will be paid to the employee's beneficiaries upon the employee's death.

Advantages

There are numerous advantages of the Executive Bonus Plan for both you — and the key employees you choose to participate.

Advantages for your business

- **Recruit, reward, and retain key employees.** The plan helps to build the loyalty of your top performers — helping to ensure that they'll stay with your firm for the long term.
- **Simplicity.** The plan is easy for your company to both set up and administer.
- **Immediate tax deduction.** Your business receives an immediate tax deduction for the bonus that you give to your executive, if the bonus is considered reasonable compensation.[1]
- **Selective participation.** It's flexible: You may choose which executives will be given bonuses — and the amount of each bonus.
- **Minimal administration.** Documentation for the plan is straightforward. A corporate resolution authorizing the plan should be included in the corporate minutes, if your business is incorporated. Neither ERISA reporting nor IRS qualification is required.

Advantages for your employees

- **Valuable protection.** There is an income-tax free death benefit for your employee's beneficiaries.
- **Cash value control.** The employee retains ownership of policy cash values that grow tax deferred and can be used for any purpose, including supplementing income in retirement.[3, 4]
- **Low cost.** The employee's only out-of-pocket cost for the plan is the tax on the bonus. You can even reduce this cost to nothing by using a "double bonus" to cover the taxes.
- **No government control or penalties.** Unlike a 401(k) plan, there are no Internal Revenue Code contribution limits, and there's no penalty for early surrenders or loans — provided the policy isn't classified as a Modified Endowment Contract.

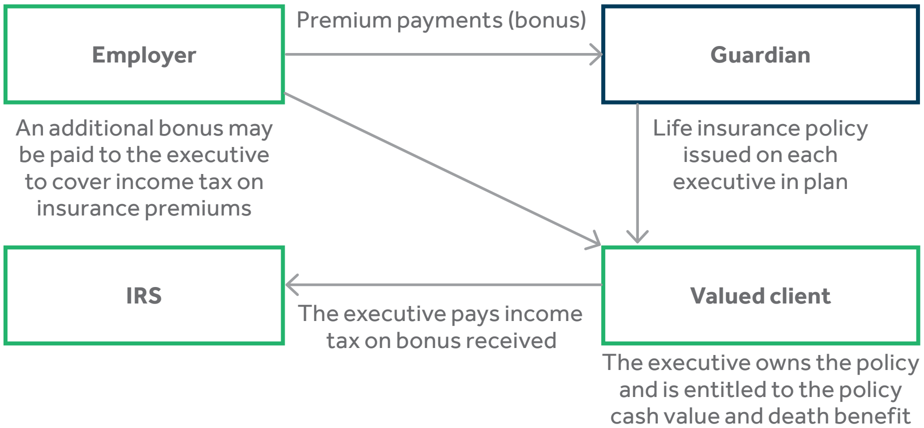
How it works

Let's review this plan in action — and then we'll describe some variations of the Executive Bonus Plan that you may wish to consider.

To initiate the process for the Executive Bonus Plan, the employee applies for a permanent life insurance policy on his or her life. The employee will be the full owner of this policy. Once the policy has been approved, the employer will pay the premium on the policy in the form of a bonus. The business will take an immediate income tax deduction for the bonus amount, and the employee will pay the taxes on it. Generous employers often choose to make the bonus large enough to cover the employee's income taxes, through what is called a "double bonus," resulting in a zero-tax outlay by the employee.

All policy ownership rights belong to the employee. He or she controls the cash value and retains the right to name the policy's beneficiaries. Perhaps most importantly, the death benefit protects your employee's designated beneficiaries in the event he or she should die. The employee can access the cash value at any time, and at retirement, can use it to provide supplemental retirement income.

How an Executive Bonus Plan works



Plan variations

Executive Bonus Plans can be customized to meet the needs of your business. Here are some creative variations:

The Executive Wealth-Building Strategy

With this type of Executive Bonus Plan, the employer pays the base premium on a whole life insurance policy and the employee may contribute additional funds as paid-up additions,[5] leveraging the employer's contribution, while fueling the growth of the cash value and the death benefit.

Here's an example of an Executive Wealth-Building Strategy in action:[6]

Among other benefits, Ben has provided his top executive, Mark, with a 401(k) plan. As Mark gets closer to retirement, he continues to contribute the maximum amount allowed to his 401(k) account. But even with the additional "catch-up" contributions that Mark is eligible to make to his account beginning at age 50, he isn't sure if he'll be able to meet his retirement income goals, so he considers an offer of employment from one of Ben's competitors.

Ben doesn't want to lose a key employee like Mark. That's why, as an additional incentive, Ben offers Mark a Guardian whole life insurance policy. Because Ben's company pays the bulk of the premium, Mark can afford to put more of his own money into the policy for a potentially greater build-up of the policy's cash value. This gives Mark a valuable life insurance policy, as well as a benefit that can help him supplement his retirement income.

As the business owner, Ben receives an income tax deduction on the bonus amount and more importantly, manages to retain one of his company's most valuable executives.

		Employer			Executive					
Year	Age	Double Bonus	Net After-Tax Outlay	Cumulative Net A/T Outlay	Premium Paid	Net After-Tax Outlay	Cumulative Net A/T Outlay	Cash Value	Death Benefit	IRR on Cash Value
1	45	$13,889	$10,972	$10,972	$12,500	$2,500	$2,500	$2,484	$473,035	-0.6%
5	49	$13,889	$10,972	$54,861	$12,500	$2,500	$12,500	$44,139	$506,698	45.5%
10	54	$13,889	$10,972	$109,722	$12,500	$2,500	$25,000	$114,328	$560,676	26.7%
15	59	$13,889	$10,972	$164,583	$12,500	$2,500	$37,500	$202,110	$634,976	19.3%
20	64	$13,889	$10,972	$219,445	$12,500	$2,500	$50,000	$321,607	$741,302	15.7%
25	69	$0	$0	$219,445	$0	-$20,785	-$53,923	$284,308	$580,386	13.2%
30	74	$0	$0	$219,445	$0	-$20,785	-$157,845	$235,231	$445,460	12.2%
35	79	$0	$0	$219,445	$0	-$20,785	-$261,768	$167,214	$329,665	11.6%
40	84	$0	$0	$219,445	$0	-$20,785	-$365,690	$72,574	$190,215	11.4%

This is a hypothetical whole life illustration and is not representative of an actual whole life insurance policy. This hypothetical illustration is intended to show, in general terms, how a typical participating whole life insurance policy might work. If purchase of a Guardian whole life insurance policy is being considered, a full illustration with guaranteed values and other important information must be provided.

The Restricted Executive Bonus Plan

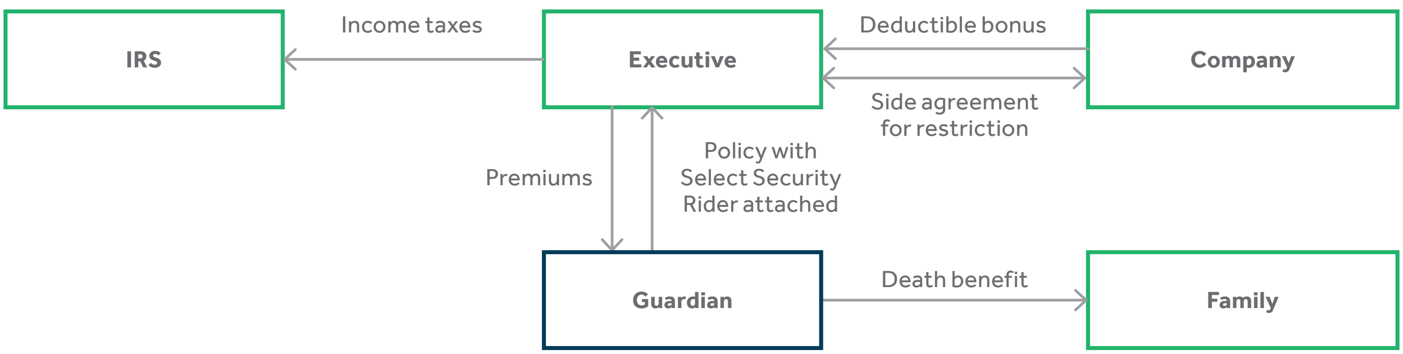
This arrangement retains the ease and simplicity of the basic bonus plan, but with an added measure of employer control, where the employer retains some rights in the policy for a specified period of time.

With the Restricted Executive Bonus Plan, an agreement is drawn up between the employer and the employee, detailing the obligations of each party under the plan. At the same time, a rider is added to the policy that restricts the employee's access to the policy's cash value until the employee has completed a specified number of years of service with the employer, as specified in the contract.[7]

The employee must fulfill all his or her obligations under the agreement (i.e., work the requisite number of years) and the employer will then sign the revocation of rights required by the rider. If the employee resigns or is fired for cause before the required period of employment ends, if addressed in the agreement, the employee may be liable for liquidated damages.

Essentially, this type of plan adds "golden handcuffs" to tie the employee to the business, since it gives the employee the incentive to remain loyal to the employer for a number of years, until the employee gains full ownership rights to the policy.

The graphic we're showing here illustrates the Restricted Executive Bonus Plan in action.



The Premiums Paid in Advance (PPIA) Bonus Plan

With this type of Executive Bonus Plan, the employer pays a one-time bonus to the executive, who uses Guardian's Premiums Paid in Advance feature to make a one-time payment that will cover all the policy premiums (without creating a Modified Endowment Contract).[8] This is an attractive plan for employers with uncertain or irregular cash flow who want to create an employee incentive, but don't want any ongoing financial obligations associated with it.[9]

Why an Executive Bonus Plan may be right for your business

An Executive Bonus Plan can give your business more control. This type of plan could be a valuable solution for your business if you:

- Want to provide a benefit where your business — not the government — decides who participates in the plan
- Would like to provide a selective benefit to yourself, as a key employee of your company
- Want to supplement existing qualified retirement plans for your top performers by enhancing their total benefits package
- Want to implement a selective benefit for key employees that has minimal administration, accounting, and legal expenses

Explore a solution that helps you attract and retain top talent — while maintaining control over your executive benefits program.

Your Guardian Financial Professional can help you decide which Executive Bonus Plan can help you achieve these objectives, while helping to protect your business financially for years to come. Contact your Guardian Financial Professional to put your plan in motion today.

[1] IRC Section 162 requires compensation to be "reasonable" in order for it to be tax deductible to the business. Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

[2] Guardian, its subsidiaries, agents and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

[3] Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal may also be subject to a 10% tax penalty.

[4] Some whole life polices do not have cash values in the first two years of the policy and don't pay a dividend until the policy's third year. Talk to your financial representative and refer to your individual whole life policy illustration for more information.

[5] Paid-up Additions (PUA) are purchases of additional insurance (death benefit) that have a cash value. These purchases are made with dividends and/or a rider that allows the policyholder to pay an additional premium over and above the base premium. This creates the growth of death benefit and cash values in a participating whole life policy. Adding large amounts of Paid-up Additions may create a Modified Endowment Contract (MEC). A MEC is a type of life insurance contract that is subject to last-in-first-out (LIFO) ordinary income tax treatment, similar to distributions from an annuity. The distribution may also be subject to a 10% federal tax penalty on the gain portion of the policy if the owner is under age 59½. The death benefit is generally income tax free.

[6] All scenarios and names mentioned herein are purely fictional and have been created solely for educational purposes. Any resemblance to existing situations, persons or fictional characters is coincidental. The information presented should not be used as the basis for any specific investment advice.

[7] Care must be taken to avoid "vesting schedules," and any requirement to pay an amount that is specifically defined with reference to the premium payments. Such provisions may jeopardize the employer's income tax deduction under IRC §162.

[8] If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal is also subject to a 10% tax penalty. Prepayment interest rates are based on current factors. Prepaid premiums cannot be withdrawn except upon surrender of the contract and are subject to a surrender penalty. Management approval is required on premiums paid in advance for more than 20 years or amounts that exceed $100,000.

[9] Depending on the facts and circumstances of a particular case, it is possible that a portion of the employer's contribution to the PPIA account will not be deductible (i.e., that portion that is not considered "reasonable").

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