John Hancock
LIFE INSURANCE

Advanced Markets | Employer Guide

Executive Bonus Plans and Restricted Endorsement Bonus Arrangements

Persuading key employees to sign-up and stay on.

Executive Bonus Plans and Restricted Endorsement Bonus Arrangements (REBAs)

In today's increasingly competitive environment, it is getting harder for companies to attract, retain, and reward talented executives, and finding a cost-effective way to reward your key employees can be challenging. Qualified plans have preferential tax treatment, but you must include all employees and reward everyone to the same degree, regardless of the benefit they bring to your company. Additionally, qualified plans have strict administration requirements that add to the cost and inconvenience. Non-qualified Salary Deferral Plans and Supplemental Executive Retirement Plans (SERPs) allow you to reward key employees in a discriminatory fashion, and are easier to administer than qualified plans. However, they still require plan documents and ongoing administration, and they also face new regulation from Section 409A of the tax code. How can you reward your most productive employees in a way that is flexible, cost-effective, and simple to administer?

Two plans may be able to help: the Executive Bonus Plan and the Restricted Endorsement Bonus Arrangement (REBA). Both of these plans are appealing to your key employees, tax-deductible to you as their employer, and simple to implement and administer. In addition, the REBA can provide "golden handcuff" incentives for your employees to stay with your company.

Executive Bonus Plan

An Executive Bonus Plan (also known as a "162 Bonus Plan") is an arrangement in which you pay a bonus to an executive by paying the annual premium on a life insurance policy for the executive. The executive will be the owner of the policy and have the right to name the beneficiaries of the policy. The executive will also own any potential policy cash value and be able to access it at retirement via tax-favored loans and withdrawals.[1]

How It Works

First, you determine which employees you would like to include in the plan, as well as the amount of bonus each employee should receive. You may pick and choose among your most valuable employees, and reward each employee at a different level. You will enter into a separate agreement with each employee, promising to pay the life insurance policy premium via a bonus as long as the employee remains with the company. The bonus will be tax deductible to you as long as it meets reasonable compensation guidelines.[2]

The executive will apply for a life insurance policy on his or her own life, and retain all rights of ownership in the policy, including access to the policy cash value and the right to name the beneficiary of the death benefit. You will pay the life insurance premium on the executive's behalf, and include this amount as a bonus in the executive's taxable compensation. The executive will be responsible for paying the income tax due on the bonus; however, you also have the option to increase the bonus amount to cover the executive's taxes. This approach is called a "double-bonus". You can discriminate among employees, providing a double-bonus for some and not others, if desired.

Pre-retirement, the executive enjoys cost-effective death benefit protection for his or her family, since the only outlay required of the executive will be the tax on the bonus, or even no cost if you elect to provide a double-bonus. The life insurance policy cash value (owned by the executive without restrictions) will grow on a tax-deferred basis. At retirement, the executive may be able to use the potential cash value in any way desired, including supplementing retirement income through policy loans and withdrawals.

Benefits

Executive Bonus Plans provide many advantages both for you and your key employees.

FOR YOU	FOR YOUR KEY EMPLOYEES
• Selective participation allowed • Discriminatory benefits allowed • May receive immediate tax deduction • Simple to install • Minimal cost to implement	• Low-cost life insurance • Immediate vesting • Executive can name policy beneficiary • Potential cash value source of supplemental retirement income

Considerations

Unlike other non-qualified benefit plans such as Salary Deferral Plans or SERPs, the employer cannot recover the cost of the bonus from either the policy death benefit or cash value, as the employee is the sole owner of the policy. Additionally, while the employee has an incentive to stay with your company in order to continue to receive the premium bonus, the employee is fully vested in the bonuses already paid and does not have to repay any amount should he or she decide to leave. If you wish to add a more vigorous vesting schedule as an incentive for your key employees to stay with the company, you may wish to consider the REBA.

Restricted Endorsement Bonus Arrangement (REBA)

A REBA is simply a more specialized form of an Executive Bonus Plan. As with the Executive Bonus Plan, you pay a bonus to an executive by paying the annual premium on a life insurance policy for the executive. The executive will be the owner of the policy, having the right to name the beneficiaries and enjoying any potential policy cash value. However, with a REBA, a vesting schedule will be applied to the bonus and the executive's access to the cash value will be restricted until the executive vests fully.

How It Works

As with the Executive Bonus Plan, first you will choose which employees will participate in the plan and how much of a bonus each employee will receive. Then, the executive will apply for life insurance on his or her life. You and the executive will execute a "restricted endorsement" at the time the policy is purchased and file it with the life insurance company. The endorsement can impose a vesting schedule and restrict the employee's access to the policy cash value until a date agreed upon in the endorsement, generally retirement or upon vesting. You may give each executive in the plan a different vesting schedule, if desired, or even have some executives not subject to a vesting schedule at all.

Your company will pay the premium for the life insurance policy on the executive in the form of a bonus. You will receive an immediate income tax deduction for the vested portion of the bonus, while the executive pays the taxes on that amount. Because of the restrictions placed on a REBA, it is common for employers to elect to increase the bonus to cover the executive's tax cost.

Should the executive leave the company before he or she has fully vested, any unvested portion of the bonus is generally paid back to the employer. If it is sufficient, the policy cash value can be used for this purpose to reduce the executive's out-of-pocket costs. At retirement, the endorsement is lifted and the executive will be able to use the potential cash value in any way desired, including supplementing retirement income through policy loans and withdrawals.

Plan Advantages

Executive Bonus Plans provide many advantages both for you and your key employees.

FOR YOU	FOR YOUR KEY EMPLOYEES
• Selective participation allowed • Discriminatory benefits allowed • May impose a vesting schedule and recover costs if employee leaves before vesting • May receive tax deduction as bonus vests • Simple to install • Minimal cost to implement	• Low-cost life insurance • Executive can name policy beneficiary • After vesting, may use the potential cash value as a source of supplemental retirement income

Considerations

A REBA is more complicated than an Executive Bonus Plan, and requires that a restricted endorsement be filed with the insurance company. Furthermore, as the employer, you will only receive a deduction for the bonus paid to the employee as it vests, rather than when the premium is paid. Some plan administration will be needed to track the vested and unvested portion of the bonus.

Although simpler than a Salary Deferral Plan or SERP, a REBA must still comply with the provisions of Section 409A of the Internal Revenue Code, and the applicable regulations. As a REBA is a non-elective deferral, and the employee pays taxes on the bonus as soon as it vests, complying with the provisions of Section 409A should not be difficult. However, you should consult your legal, tax, and accounting advisors to make sure you are in compliance.

SAYER TRAVEL AND CHARLIE ALLNUT

Sayer Travel is a successful travel company that arranges safaris and river trips in Africa. Its owner and CEO is Rose Sayer. Last year, Rose hired Charlie Allnut away from her main competitor. Charlie is an experienced guide and river man who has been very popular with the tourists. Now that Rose has acquired Charlie, she would like him to stay with Sayer Travel for a long time. Rose decides to implement a REBA. Although Rose has many employees, only Charlie will participate in the plan because he is the only employee she is anxious to reward. Charlie will apply for a $1,041,666 Accumulation UL policy on his life, with an increasing death benefit and an initial premium of $50,000. Rose will double-bonus him $55,385 in year one, so at Charlie's tax bracket of 35%, he will have enough to pay both the premium and the taxes with no out-of-pocket costs to himself. Charlie and Sayer Travel will execute a restricted endorsement with a five-year rolling vesting schedule and file it with the insurance company. Sayer Travel will deduct the bonus and enjoy a tax savings of $6,154 at its 40% tax bracket. Charlie will own the policy and enjoy the death benefit protection for his family, as well as any potential policy cash values. As long as he stays with Sayer Travel, Rose agrees to pay the double-bonus. If Charlie stays until retirement, he has access to the policy cash value in the form of loans and withdrawals to supplement his retirement income.

YEAR	BONUS*	TAX DUE	PREMIUM	LOANS AND WITHDRAWALS	CASH SURRENDER VALUE (Non-guaranteed assumptions, 5.30% NET)	DEATH BENEFIT	EMPLOYER TAX SAVINGS
1	$55,385	$5,385	$50,000	$0	$23,789	$1,086,612	$6,154
5	$76,923	$26,923	$50,000	$0	$238,289	$1,291,709	$30,769
10	$76,923	$26,923	$50,000	$0	$571,578	$1,613,244	$30,769
20	$76,923	$26,923	$50,000	$0	$1,559,991	$2,361,085	$30,769
25	$0	$0	$0	$146,553	$1,177,558	$1,628,320	$0
30	$0	$0	$0	$146,553	$685,911	$842,324	$0
35	$0	$0	$0	$146,553	$49,036	$130,892	$0

* Double-bonus amounts and corresponding employer tax deductions will increase over time as Charlie vests in a greater proportion of the premiums paid.

This is a supplemental illustration authorized for distribution only when preceded or accompanied by a basic illustration from the issuer. Benefits and values are not guaranteed; the assumptions on which they are based are subject to change by the insurer. Actual results may be more or less favorable. Refer to the basic illustration for guaranteed elements and other important information.

SAYER TRAVEL AND CHARLIE ALLNUT (continued)

Now let's assume that Charlie decides to leave Sayer Travel in year 11. According to the vesting schedule, he must pay back $100,000 of the bonus. Based on the current interest rate and current cost-of-insurance charges, Charlie can withdraw the $100,000 from the policy, stop paying premiums, and still enjoy some supplemental retirement income.

YEAR	BONUS	TAX DUE	PREMIUM	LOANS AND WITHDRAWALS	CASH SURRENDER VALUE (Non-guaranteed assumptions, 5.30% NET)	DEATH BENEFIT	EMPLOYER TAX SAVINGS
1	$55,385	$5,385	$50,000	$0	$23,789	$1,086,612	$6,154
5	$76,923	$26,923	$50,000	$0	$238,289	$1,291,709	$30,769
10	$76,923	$26,923	$50,000	$0	$571,578	$1,613,244	$30,769
11	-$100,000	$0	$0	$100,000	$496,413	$1,513,244	$0
20	$0	$0	$0	$0	$756,688	$1,513,244	$0
25	$0	$0	$0	$67,165	$577,839	$1,177,419	$0
30	$0	$0	$0	$67,165	$344,478	$801,479	$0
35	$0	$0	$0	$67,165	$35,443	$282,825	$0

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As demonstrated above, the plan will provide benefits to both Rose and Charlie. Rose has a tax-deductible benefit that she can use to show Charlie how much she values his contributions and to encourage him to stay with Sayer Travel. Charlie will enjoy the death benefit protection and potential policy cash values with minimal cost to himself, because of the bonus from Sayer Travel. With a REBA, both employer and employee win.

Summary

Executive Bonus Plans and REBAs both offer you a simple, tax-deductible way to recruit, reward, and retain the people who matter the most to your business. With both plans, you decide which executives participate, how much of a bonus they will receive, and what their vesting schedule will be. You even have the flexibility to offer some employees an Executive Bonus Plan, and others, a REBA. The decision is yours. Your John Hancock representative can help you by providing customized insurance illustrations to demonstrate how each of these plans might work for you.

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1. Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½.
2. The amount of the bonus that the employer is able to deduct is subject to reasonable compensation limits. A detailed discussion of this is beyond the scope of this document. Clients should consult their tax advisors.

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