Executive Bonus Arrangement[1]

An executive bonus arrangement is a method of compensating selected key employees in which the employer pays the premiums of a life insurance policy covering the employee's life.

How the Plan Works

- **Life insurance policy:** The employee purchases, and is the owner of, a life insurance policy on his or her own life. The employee retains – at all times – the right to name the policy beneficiary and to receive the death benefit.
- **Employer not a beneficiary:** The employer cannot be the beneficiary, either directly or indirectly, of the insurance policy.
- **Written agreement:** A written agreement provides for payment of a "bonus" in exchange for the employee's agreement to continue working for the employer. The employer may also wish to pay a "double bonus" to help cover the employee's additional income tax liability.
- **Premium Payments:** The employer may make the premium payments directly to the life insurance company, or the payments may be included in the employee's paycheck, with the employee paying the premiums.
- **Tax treatment – employee:** The employee includes in current income – and pays tax on – the net premium paid by the employer.
- **Tax treatment – employer:** Subject to the "unreasonable compensation" rules, and as long as the employer has no interest in the policy, the additional compensation is deductible to the employer as an ordinary and necessary business expense.

Benefit to Employer	Benefit to Executive
Can reward selected key executives, with varying coverage amounts.	Executive owns the policy. If he or she changes employers, the policy is not lost.
Simple to implement, with little or no administration costs	Accumulated cash values can be used in emergencies, at retirement, or for personal investments.[2]
Premium costs are tax deductible.	Death benefit is generally received income-tax free.
Can be stopped without IRS approval or restrictions.	Proceeds may be used for estate settlement costs.

[1] The discussion here concerns federal income tax law. State or local income tax law may vary.

[2] A policy loan or withdrawal will generally reduce cash value and death benefits. If a policy lapses, or is surrendered with a loan outstanding, the loan will be treated as taxable income in the current year, to the extent of gain in the policy. Policies considered to be Modified Endowment Contracts (MECs) are subject to special rules.