Executive Bonus Plan

IRC Sec. 162 Bonus Plan

An executive bonus plan is a method of compensating selected key employees by paying the premiums of a life insurance policy on the employee's life.

Some Requirements to Make the Plan Work

- Employer cannot be the beneficiary of the insurance. See IRC Sec. 264(a)(1).
- The amount of the premium is additional compensation to the executive. (Subject to unreasonable compensation rules.)
- There should be a written agreement between employer and employee.
- Executive must pay current income tax on the amount of the net premium paid by the employer. (Employer can bonus the extra money needed to pay the tax or it can be paid by policy loans or withdrawals.)

Benefits to Employer

- Can reward key executives.
- Selective participation is allowed (no discrimination rules).
- Costs are tax-deductible.
- Creation of plan is simple.
- No administration.
- Amounts of coverage on various employees can differ.
- Plan can be terminated without IRS approval or restrictions.

Benefits to Executive

- Executive owns the policy[1] and cash values. If he or she changes employers, the policy is not lost.
- Accumulating cash values will help in emergencies, at retirement or for personal investments.
- The death benefit may be income tax free. See IRC Sec. 101(a).
- Proceeds may be used for estate settlement costs.

[1] Some tax practitioners feel that an executive could agree (through a policy endorsement) not to change ownership or borrow against the policy without the employer's consent.