

Reward Key Employees with  
**Executive Bonus Plans**



*Give your employees—and your business—a bonus*



As an experienced business owner, you know how critical it is to protect your competitive advantage. Often that advantage is your great employees. But how do you help ensure these key people remain loyal to your company?

Surprisingly, the answer may be simpler than you think. Helping employees meet their goals, like saving for retirement and protecting their loved ones, can be a great way to inspire loyalty. And one smart, simple way to do this can be to offer an executive bonus plan. **These supplemental employee benefit plans go further than traditional qualified plans to provide additional retirement benefits, provide permanent life insurance protection, and much more**—helping you to reward and retain the people that help make your company successful.

*Your employees are critical to your success. How can you reward them for their contributions and make sure they want to stay?*

## Help Employees Close The Gaps

Employees are facing more challenges than ever today and are looking for companies to help them meet their needs. Executive bonus plans, also known as Section 162 plans, offer you a way to provide your key employees the additional benefit of permanent life insurance. By paying policy premiums with a bonus, rather than simply giving cash, you can help your team members to close both the retirement income and life insurance gaps, providing the protection they need, while establishing your business as an employer of choice.

### The Retirement Income Gap

Financial experts tend to agree that to maintain current lifestyles in retirement will require 70-90% of pre-retirement income. But with qualified plan and Social Security limits, how is an executive supposed to meet this goal? Consider that Social Security was designed to provide supplemental retirement income, not to replace large incomes. Additionally, qualified plans cap the dollar amount that can be contributed. So with both Social Security and qualified plans, the more that is earned, the less that can be replaced. For example, at current limits:

- An employee who makes \$50,000 per year is able to contribute up to 37% of their salary and will have Social Security replace 34% of their salary during retirement.<sup>1</sup>
- An employee earning \$300,000 per year is only able to contribute 6% of their salary and will only receive about 12% of their pre-retirement income from Social Security during retirement.<sup>1</sup>



## The Life Insurance Gap

Life insurance is not a topic that people tend to want to speak about, but it is an important one. And the truth is that most of your employees are likely underinsured. Consider that, according to the Life Insurance Market and Research Association (LIMRA), over 20% of Americans who have life insurance do not believe they have enough.<sup>2</sup> If the primary wage earner died today:

- 69% of U.S. households would have trouble paying living expenses in two years or less<sup>2</sup>
- 40% would have trouble immediately <sup>2</sup>

And while term insurance can be an affordable way to help employees meet their short-term needs, only permanent life insurance can provide both long-term protection and cash value that builds over time.

### Percentage of households with individual life insurance<sup>3</sup>



2016

There is a  
**\$15.3 trillion**  
estimated unmet life  
insurance need in the U.S.<sup>3</sup>

**84%**

of consumers think  
most people need life  
insurance, but only

**70%**  
have it...<sup>3</sup>

*You have built a strong team. Imagine how you would feel if one of their families was left unprotected and unable to pay bills following an unexpected death?*

<sup>(1)</sup> This example is provided for illustrative purposes only. Benefits based on retirement age of 67 in June 2017, does not assume COLA adjustments (<https://www.ssa.gov/oact/quickcalc/>).

<sup>(2)</sup> LIMRA and Life Happens, 2017 Insurance Barometer Study

<sup>(3)</sup> LIMRA, Facts About Life, 2016



## Executive Bonus. Select Advantages.

Executive bonus plans can provide a number of advantages for the employees you select. They offer employees the potential for supplemental income and protections, are flexible and relatively simple to implement—and can help your business to recruit, retain and reward key employees.

### Flexibility and Simplicity

Executive bonus plans provide the flexibility for you to select just a few employees (or even one) to participate without having to worry about complying with the Employee Retirement Income Security Act (ERISA), complex administration, or other discrimination tests or requirements. You can select any key employees to participate, can bonus a significant amount (as long as it is reasonable compared to their salary), and have several plan options available. And, unlike traditional qualified plans, there are typically no mandatory contributions.



### Executive Bonus Plans Defined

An agreement between a company and an employee whereby the company agrees to pay the premiums on a life insurance policy owned by the employee that will provide a death benefit and supplemental retirement income.

#### How it works:

1. Your business agrees to give your employee, Jordan, a bonus in the form of permanent life insurance.
2. The company bonuses Jordan by either giving her cash to pay the premium or paying the policy premiums for her.
3. Your business gets a tax deduction the year the bonus is paid.<sup>1</sup>
4. Since the bonus is considered income, Jordan pays the taxes on it (there are numerous options for this that we will outline later.)
5. Jordan is the owner of the policy and names the beneficiaries. She gains a death benefit that protects her family, potentially tax-free access to the accumulated cash value in retirement and possibly for emergencies, and the ability to make additional contributions. This pre-retirement access can be restricted using a vesting schedule.



*Nearly 79% of employees would prefer new or additional benefits to a pay increase.<sup>2</sup>*

<sup>1</sup>The deduction will not be allowed if the total compensation to the employee is unreasonable.



<sup>2</sup>Glassdoor, Employment Confidence Survey, 2015





## A Win for Your Business and Your Employees

Executive bonus plans provide a winning combination of benefits for your company and your employees.

	
The Business	Key Employee
Can select which employee(s) can participate	Helps fill the retirement income gap
Not subject to restrictions of qualified plans	Gain the potential for tax-deferred growth of values
No IRS approval is needed	Tax-free death benefit protection for family
Flexibility to customize plan	Tax-free supplemental retirement income potential
Bonuses are immediately deductible as long as they are reasonable	Access to cash for emergencies
Ability to restrict access to cash value to encourage employees to stay	Disability, a variety of optional benefits.
	May be able to contribute additional amounts to the policy
	Policy is typically a portable benefit that the employee can take with them

*Executive bonus plans enable your business to help team members close the retirement gap and the life insurance gap—helping to ensure loyalty to you.*



## Executive Bonus Plan Options

All executive bonus plans offer you the flexibility to pick the key employees you want to bonus, to contribute different amounts each year (depending on the agreement), and to take advantage of simple administration. There are, however, different options that enable you to help your team members pay the income taxes due on their bonuses. You can select the option that works best for you or your employees.

### Tax Payment Options

It is important to note that since the bonus is considered income, taxes are due when it is paid. Additionally, this bonus can, in some circumstances, place the employee in a higher tax bracket.

Single Bonus	Double Bonus	Premier Bonus'
<ul style="list-style-type: none"><li>▪ Your company bonuses the amount of the premium due</li><li>▪ The employee pays the taxes due on the bonus out of their current income</li></ul>	<ul style="list-style-type: none"><li>▪ Your company grosses up the bonus to include the bonus and the cash necessary to pay the taxes due</li><li>▪ The employee pays the taxes due with the additional cash you bonused them—essentially paying nothing out of pocket</li></ul>	<ul style="list-style-type: none"><li>▪ Your company bonuses the amount of the premium due</li><li>▪ The employee takes a loan from the policy's cash value to reimburse themselves for paying the taxes paid the prior year</li></ul>



### **Gain More Control With A Restricted Bonus**

Of course, one of the most compelling reasons for a business to offer a bonus plan is to gain the ability to create “golden handcuffs” that encourage your employees to remain loyal to you. A “restricted” executive bonus enables you to use vesting schedules, performance requirements, or other criteria to help ensure your employees stay employed with you. To create this type of bonus will naturally require a more formal plan agreement between you and your employees, but it is still simpler than traditional qualified plans.

*While cash bonuses can be spent immediately, a life insurance policy is a true supplemental benefit that provides many advantages to employees and their families.*

## Considerations

There are federal tax and other considerations that both businesses and key employees should take into consideration when establishing executive bonus plans. Your tax advisor and Financial Professional can help you better understand all of the variables.

### Ideal Situations

Executive bonus plans may be best suited for small, family-owned or privately held businesses looking to attract, reward and retain executives and other key employees. Depending on the type of company entity, however, these types of plans may be more—or less—attractive. Companies should consider whether or not their cash flow will continue to support a bonus arrangement going forward and should consult a tax advisor.

### Plan Assets Are Personal Assets

In all instances, the assets in an executive bonus plan are considered personal assets of the employee. The bonuses are taxable in the year received and may push the employee into a higher tax bracket. Additionally, should the business not pay the premium in a given year, the employee may be required to do so in order to keep the policy in force. Policies, once fully vested, are portable and can go with the policyholder.

### Plan Administration

Although executive bonus plans are very low cost to administer and quite flexible, your business should consider having a board resolution at minimum. Without restrictions, an employee has all ownership rights in the policy - so if your business desires to implement a restricted executive bonus plan that will limit the cash value access, you will need a more formal plan agreement.







## The Key To Your Success

Key employees are critical to the success of your business. And the secret to keeping them happy may be helping them save for retirement and protect their families.

Executive bonus plans let you select who you would like to reward and offer you several options to choose from. Each lets your employees save more for retirement than traditional qualified plans, while providing permanent life insurance benefits as well—helping them to close the retirement and insurance gaps, while inspiring loyalty to your business.

*Your Financial Professional can help you find the right solution for your business to help you attract, reward—and retain—key employees like you.*



## Our Noble Purpose

Since 1847, Penn Mutual has been driven by our noble purpose — to create a world of possibilities, one individual, one family and one small business at a time. As an original pioneer of mutual life insurance in America, we believe that purchasing life insurance is the most protective, responsible and rewarding action a person can take to build a solid foundation today and create a brighter future for generations to come.

Life insurance policies contain exclusions, limitations, reductions of benefits and terms for keeping them in force. Accessing cash values may result in surrender fees and charges, may require additional premium payments to maintain coverage, and will reduce the death benefit and policy values. Loans and other policy withdrawals may be taxable under certain circumstances. All guarantees are based upon the claim-paying ability of the issuer.

This information is not intended to be comprehensive legal advice on executive bonus plans. Any reference to the taxation of life insurance products in this material is based on Penn Mutual's understanding of current tax laws which are subject to change. You should obtain qualified tax counsel relative to your particular financial situation.