Restrictive Executive bonus Arrangements (REBAs)

- **using Life Insurance**

Increased productivity occurs because of dedicated employees. Successful business owners know dedication is generally instilled from the top-down.

To maintain a competitive position in the marketplace, business owners must be able to develop and retain top executives – and salary alone may not be enough.

Executive bonus arrangements (also known as Section 162 bonus plans) can be used by an employer for the executive's purchase of life insurance. Generally, the employer pays the premium but charges the executive with a bonus. In some cases, the employer pays a bonus to the executive for the amount of the premium. Note: ERISA issues can arise if this arrangement is mishandled, so working with the appropriate professionals is important.

Unfortunately, the implementation of a standard executive bonus arrangement doesn't always ensure the employer will reap the intended benefits. For example, the executive may:

- Decide to retire early
- Leave to take a position with another company
- Resign to start up a competing company
- Engage in activities detrimental to the employer

Restricted Bonus Arrangements (REBAs)

The REBA is a simple, straightforward method of rewarding an executive over and above salary and standard benefits.

The executive applies for, owns, and names the beneficiaries of a life insurance policy – the benefits of using life insurance as the funding vehicle will soon become apparent. Through the REBA, the employer pays the insurance premium directly to the insurance company or pays the bonus to the executive who then pays the policy premium. The payment is considered ordinary income for the executive and is taxable under the normal income tax rate [I.R.C.#61(a)]. The bonuses, if reasonable compensation, are tax deductible for the employer when paid [I.R.C. #162(a)(1)]. Note: Employer bonuses are treated as wages and subject to FICA and FUTA withholding.

To be deductible by the employer, the bonus must be related to services rendered and must represent reasonable compensation. If deemed unreasonable, it is treated as a dividend and not deductible by the employer.

Potential Advantages of a REBA

Potential Employer Benefits:

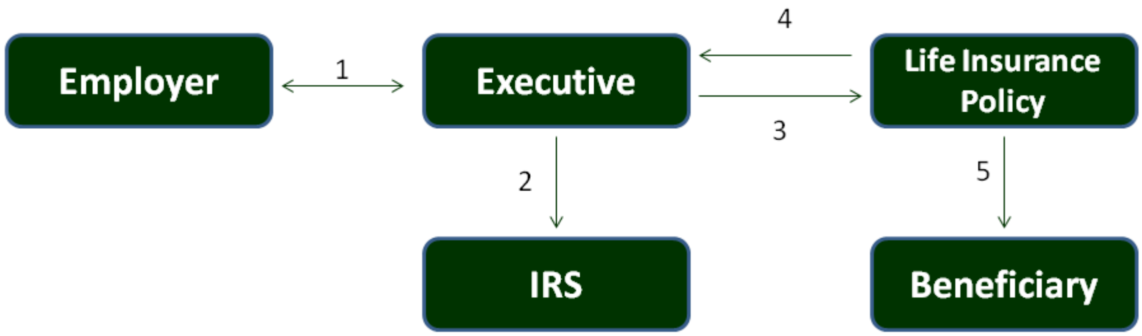
1. Reward to selected key executives
2. Amounts of insurance coverage and bonuses can be different for each executive
3. Size and amount of bonus can vary from year to year to reflect executives' work and company profitability.
4. Arrangement can be terminated without IRS notification, approval, or restrictions.
5. Contributions are fully deductible as long as total compensation is reasonable.
6. Relatively simple and easy to administer
7. Executive can agree (using policy endorsement) not to change ownership or borrow against policy for a period of time without employer's consent.
8. A REBA may not be required to comply with Section 409A and it's regulations. Note: Consult legal counsel regarding REBA design.

Potential Benefits for the Executive

1. Can be customized to meet the executive's individual needs
2. Beneficiary death benefits are generally income-tax free [I.R.C. #101(A)(1)].
3. Policy cash values potentially grow income-tax deferred and can be available for emergencies, retirement, or other needs with the employer's consent.
4. The executive may voluntarily contribute personal funds to the policy (not subject to REBA restrictions) to potentially increase cash value growth and supplemental retirement income.
5. Once REBA restrictions have lapsed, retirement benefits can be accessed income tax free through proper structuring and use of withdrawals to cost basis and policy loans as long as the policy remains in force.
6. Executive owns the policy and policy values are not subject to the claims of the business' creditors.

See "REBA": How it works" on the next page.

REBA: How it works:



1. **Employer and executive enter into an agreement. Employer agrees to pay an annual bonus which will be used to pay premiums on a life insurance policy. Parties may file a restrictive endorsement form with the issuer to restrict the executive's ability to exercise ownership rights during the term of the agreement ('golden handcuffs'). Bonus payments are tax deductible by the employer assuming total compensation is reasonable.**
2. **Executive pays tax on bonus as ordinary income.**
3. **Executive applies for, and owns,, life insurance policy**
4. **Executive may receive income through withdrawals and loans from the policy's cash value, subject to restrictions in the agreement***
5. **At executive's death, income tax-free death benefit proceeds are paid to the executive's beneficiary.****

•Varies by state and may reduce available surrender value and death benefit, or cause the policy to lapse if not designed properly. Consult with your tax, legal and financial professional.
**Benefit is generally tax-free and, if properly structured, ay be free of estate tax, assuming the policy qualifies as life insurance and does not lapse.

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