RESTRICTED BONUS PLAN

Key Employee Compensation Strategy

Retaining, recruiting, and motivating key employees

While each of your employees contributes to the success of your business in their own way, you may very well have a number of employees who are crucial to attaining critical business objectives.

These key employees may play an integral role in the success of your business. They may have unique skill sets, specific knowledge and experience in the industry, or bring valuable relationships to the table. They may be sought after by your competitors and, if they were to terminate their employment with you, they could possibly become one of your competitors in the future.

Just as each business has a value proposition it offers its customers, the total compensation package you offer key employees is part of your value proposition to them. There are many different forms of compensation and benefits an employer may offer. Each one is designed to retain, recruit, and motivate the talent you need to succeed. Like other business decisions that require an allocation of financial and human resources, it is important to take a strategic approach.

AMK-507 (R-7/2024)

Selecting a key employee compensation plan

There are many reasons why an employee may choose to dedicate their time, talents, and energy to your business. It could be the corporate culture, the challenges the job presents, the potential for advancement, or simply the people they'll work with. But employers who develop a compensation strategy that balances the employee's need for financial rewards with the business's need for high-performing, motivated, loyal employees should have a leg up on their competitors.

A key employee bonus plan may be an effective way to accomplish these goals.

How a key employee bonus plan works

A key employee bonus plan is a simple plan in which an employer pays annual bonuses to a key employee, and the bonuses are used to purchase a cash value life insurance policy. As long as the employee remains with the employer, the employer may continue making annual bonuses.

It is a flexible form of incentive compensation that requires minimal administrative costs or time commitment from human resources. There are very few limitations on the amount, timing, performance measures, or number of employees included in the plan.

As long as the bonus is a reasonable amount, the employer may deduct the payments when made. While the employee will recognize bonuses as taxable income in the year received, when designed properly, the employee may take income-tax-free policy loans and/or withdrawals[1] to supplement retirement income.

Benefits to you, the employer

- The bonuses to pay the premium on the insurance policy are tax-deductible for your business if considered reasonable compensation.
- Minimal administration time and/or cost.
- No limitations on the number of employees or which employees receive bonuses (including business owners).
- Not subject to onerous ERISA requirements.
- Contribution amounts are flexible and may be different for each key employee.

Benefits to the employee

- The employee has ownership and control of the IUL policy.
- There is generally an income-tax-free death benefit for chosen beneficiaries.
- The employee has access to any available cash value through income-tax-free policy loans or withdrawals;[1] these can be used to supplement retirement income.
- Portability of the policy. Since it is employee-owned, the policy can remain with the employee should employment terminate.

[1] Policy loans and withdrawals will reduce the available cash value and death benefit and may cause unintended consequences, including lapse or taxable events. Please see the full loan and withdrawal disclosure within this material for details.

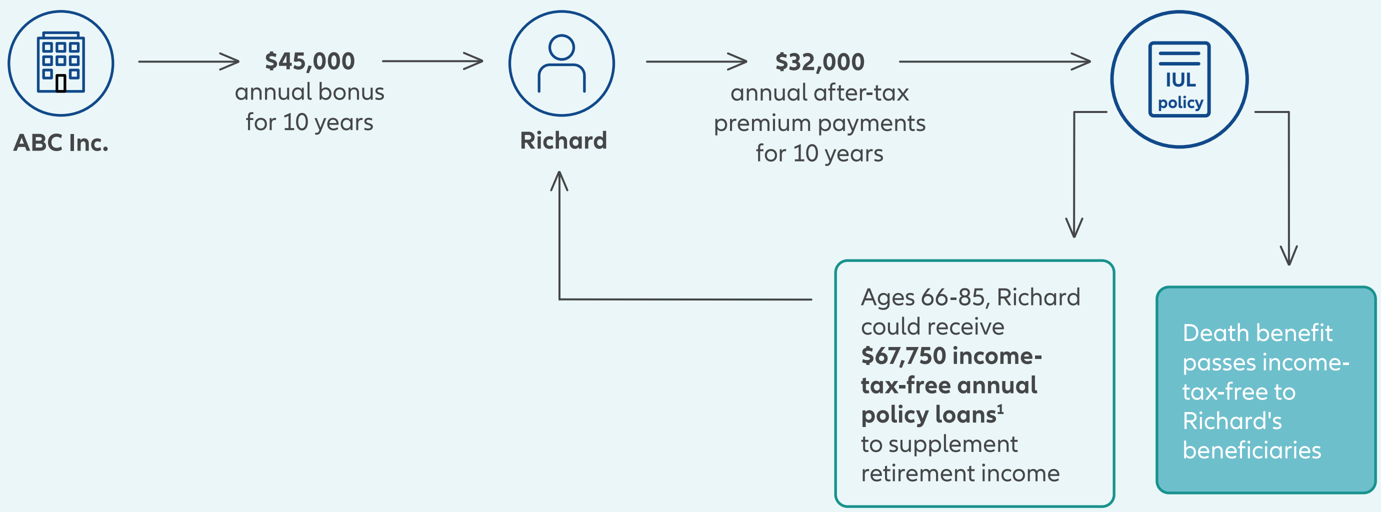
Let's look at a hypothetical example

ABC Inc. is a local business that has 20 employees. The business provides all employees with a qualified retirement plan (a 401(k) plan) and matches employee contributions. Five years ago, they hired Richard Frank and named him Vice President of Sales. Since then, sales have grown substantially, and Richard is now critical to the business and their future plans. The owners of ABC Inc. would like to provide Richard, exclusively, with an incentive to remain with the company.

ABC Inc. will bonus $45,000 annually for 10 years to Richard. After paying taxes on the $45,000, Richard uses the remaining bonus, approximately $32,000 a year, to purchase an indexed universal life (IUL) insurance policy. ABC Inc. may also consider paying an additional cash bonus to Richard to cover the tax on the bonus.

Richard purchases an Allianz Life Accumulator™ Indexed Universal Life Insurance Policy with an initial death benefit of $457,094. In the event of his passing, the death benefit would be left to his beneficiaries.

If Richard decided to retire at age 65, he could access the available cash value through policy loans or withdrawals.[1]



Total premium paid: $320,000

Supplemental income through annual loans:[1] $67,750 (ages 66-85)

Assumptions: Allianz Life Accumulator™, 45-year-old male, 10 annual premium payments of $32,000, initial death benefit $457,094, 5.50% nonguaranteed illustrated rate, 1% annual interest bonus opportunity, indexed loans.

Assuming a minimum guaranteed illustrated rate of 0.10% and maximum fees and charges were applied, the cash value would not be sufficient to support a loan strategy, and the policy would lapse in policy year 24. When taking policy loans, you need to be sure that you are managing the policy values and premium payments to ensure that the policy remains in force.

IUL is not a source of guaranteed retirement income.

This hypothetical example is provided for illustrative purposes only. The character is fictional and not an actual Allianz client. The hypothetical example is intended to show how features such as product benefits, accumulation potential, and loan features work and is not intended to predict future results. Actual results may be different from the figures shown and, in some cases, may be significantly higher or lower. It also may not be realistic to receive an interest bonus every year. Bonused products may include higher surrender charges, longer surrender periods, lower caps, or other restrictions that are not included in similar products that don't offer a bonus. The index allocations that offer the interest bonus will generally have lower caps and participation rates.

[1] Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy. If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change, and you should consult a tax professional.

Considerations

- The employee must be insurable; life insurance policies require health and financial underwriting.
- The business does not have any ownership or other rights to the life insurance policy.
- There are generally costs to the employer for hiring an attorney to draft the executive bonus legal documents.
- The bonus paid to the employee is taxable income. However, the employer may provide a "double bonus" to cover the employee's tax.

Consult with your tax and legal advisors on the full ramifications of using an executive bonus plan in your business.

Using a restricted executive bonus arrangement (REBA) as a key employee retention strategy

A REBA offers the same benefits and considerations as a typical executive bonus; however, with a REBA, the employee cannot access the available cash value without the employer's consent.

If the employee remains with the business until a predetermined date, the restriction on the policy will be lifted, and the employee will have access to any available cash value accumulation.

This type of strategy – sometimes known as "golden handcuffs" – can provide a strong incentive for employees to maintain their employment with your business.

Note: The policy restrictions are documented by a restricted endorsement agreement and submitted along with the application for life insurance. The date for release is typically included in an employment agreement between the employer and the employee. Both documents should be drafted by your licensed attorney.

CAN AN EXECUTIVE BONUS PLAN be appropriate for your business?
Call your financial professional today to start the discussion.