Portability is a key feature of an insurance policy funded through Executive Bonus Plan

A life insurance trust (ILIT) that serves as both owner and beneficiary of the policy. Properly structured, insurance policies owned within an ILIT may be deemed to be outside the employee/insured’s estate and escape estate taxation upon the employee’s death. Amounts transferred by the employee to the ILIT trustee to pay ongoing premiums may, however, be deemed taxable gifts by the employee to the ILIT.

An Executive Bonus Plan funded with life insurance may also provide an excellent financial source to guarantee completion of a business succession or buy-sell arrangement between business associates and shareholders.

**Applying Restrictions to Portability**

One of the key benefits of individually owned life insurance funded through an Executive Bonus Plan is the portability of the policy. Employees know they own something that has value not tied to the success of the business or the whims of its management. Employers concerned about the portability issue have some options. For example, the plan can require the employee to enter into a restrictive endorsement of the policy cash values in favor of the employer for a stipulated period of time or upon the attainment of a specified event. As a result, the employee has restricted access to the policy cash surrender value, but his/her beneficiaries always have full access to the policy death benefit.

Executive Bonus Plans have found favor with both employers and employees for many years because of the simplicity of their administration, straightforward income tax consequences and perceived economic value. Nevertheless, the interplay between employer funding and employee ownership of life insurance policies strongly suggests the need for advice from qualified legal and tax counsel in conjunction with an experienced insurance professional.

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All businesses are in competition. They compete to bring the best products and services to the market. They also compete to employ the best and brightest talent available. In order to stay competitive, however, employers must compensate their most highly valued employees in meaningful ways. Salaries and other employee benefits may not be enough. Such compensation may also miss the mark with respect to helping key employees fund the benefits they really need. In addition to qualified retirement plans, stock option plans and other employer-provided benefits, an Executive Bonus Plan can perhaps either attract or keep the employee that helps make your business successful.

**Plan Structure**

An Executive Bonus Plan is designed primarily to provide an employee with additional compensation in order to purchase and own a life insurance policy benefiting the employee and his/her family. An employer can pay bonuses directly to the employee, who then uses the bonuses to pay insurance premiums. Alternatively, the employer can pay premiums directly to the insurance company. Executive Bonus Plans are often considered a benefit plan of choice by employers and employees because, properly structured, such plans are not governed by ERISA or any of the governmental restrictions applying to qualified retirement plans. Employers can choose employees who may participate in the plan and revise their plans without governmental oversight.

**Income Tax Consequences of Funding Executive Bonus Plans**

The bonus paid to an employee or paid by the employer directly to the insurance company as premium is generally realized as ordinary income by the employee in the year received. Consequently, for non-pass-through business entities such as C corporations, such bonuses may be entirely income tax deductible in the year of payment, subject to reasonable compensation restrictions set forth under I.R.C. Sec. 162. Some employers choose to provide a “double bonus” to the employee.

In addition to covering the required insurance premium, the double bonus also provides sufficient additional compensation to the employee to pay income taxes payable as a result of the bonus. From an income tax arbitrage perspective, an Executive Bonus Plan may be particularly attractive to C corporations subject to a higher income tax rate than the employee receiving the bonus.

**Why Life Insurance?**

Employers often choose life insurance to fund an Executive Bonus Plan for several reasons:

- Life insurance policies have historically provided a safe and secure method to provide their owners’ chosen beneficiaries with death benefits when often needed the most
- Permanent life insurance policies may accumulate substantial cash surrender value over time. Cash surrender values generally accumulate on an income tax-deferred basis.
- Through the use of policy cash value withdrawals up to the premiums paid and policy loans thereafter, owners may be able to obtain a source of income on a tax-advantaged basis
- Policy owners may choose to access cash surrender values to supplement retirement and other needs

**Selecting the Appropriate Policy**

Most Executive Bonus Plans are funded with permanent cash value life insurance. There are several reasons for this:

- Some permanent life insurance policies offer a guaranteed level premium and death benefit structure during the term of the policy
- Policy cash accumulation values may provide an attractive benefit to the employee
- Some policies offer substantial flexibility of both premium and death benefit structures extending into the future

Executive Bonus Plans may be funded by guaranteed whole life policies, fixed universal life policies, indexed universal life policies, or variable universal life policies. Policy choice generally depends upon the needs of the employee and perceived risk tolerance.

**Estate and Business Planning Applications**

Policies funded through Executive Bonus Plans may have ownership and beneficiary structures that provide for substantial estate tax relief. For example, an employee using a bonus may establish an irrevocable