Executive Benefits for Business Owners and Key Employees

Executive Bonus Plans

GUARDIAN®

recruit, retain, **and** reward **selected executives**

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On the Cover

TREFOIL KNOT—Recruit, Retain, Reward

Providing integrated plans with flexibility and customization to recruit, retain, and reward selected executives.

The Business Owner's Challenge: *Recruit, Retain* and *Reward*

- ❑ Are you a business owner?
- ❑ Do you want to provide incentives to recruit, retain and reward top-level employees?
- ❑ Do you want to provide a benefit where you decide, not the government, who participates in the plan?
- ❑ Do you want to supplement existing qualified retirement plans for your key employees by enhancing their total benefits package?
- ❑ Do you want to provide selective benefits to your key employees at a minimal cost to the business?
- ❑ Do you want to implement a selective benefit to key employees that has minimal government reporting?
- ❑ Do you want to implement a selective benefit to key employees that has minimal administration, accounting and legal expenses?
- ❑ Would you like to provide a selective benefit to yourself, as an employee?

If you answered "Yes" to one or more of these questions, you should explore the many benefits associated with Executive Bonus Plans.

Recruit,

Retain,

Reward.

Executive Bonus Plans: Simple and Effective

As the owner of a closely-held company you understand the critical importance that key employees play in the success of your business. In addition to paying an attractive salary, you must offer a competitive benefits package to recruit talented people to your organization and provide additional perks to retain and reward them.

For example:

A qualified retirement program such as a 401(k) plan is a fairly common employee benefit but often it is insufficient by itself to provide the level of benefits that executives expect from their employer. Qualified retirement plans are subject to significant rules and regulations that limit the annual contribution amounts, may restrict highly compensated employees from contributing, and prohibit employers from picking and choosing which employees may participate. Indeed, as a business owner, you may sometimes find your company's benefits package lacking for your own personal needs.

So, what other option do you have for providing extra benefits to executives and key employees to help recruit, retain and reward them? The answer is: a nonqualified executive benefit plan.

Unlike qualified retirement plans, nonqualified executive benefit plans allow you to select the employees that you wish to cover and exclude others. These plans provide for supplemental sources of retirement income, as well as risk protection from death. The contributions that you may make to nonqualified plans are not set by the government but by business objectives. Also, the administrative requirements are nominal compared to qualified plans.

Among nonqualified executive benefit plans, the most popular is perhaps the Executive Bonus Plan. Its popularity is due to its simplicity, relative lack of restrictions, and tax benefits to the employer.

As a Business Owner, Why Would You Choose to Implement an Executive Bonus Plan?

An Executive Bonus Plan using permanent life insurance is the simplest form of an executive benefits program. It is easy for both employers and employees to understand. Why? An Executive Bonus Plan is simply a personally owned permanent life insurance policy paid for by the business resulting in a tax deduction for the business. No IRS approval is necessary. The plan does not fall within the requirements of ERISA[1] like qualified retirement plans, and there is virtually no administration or costly accounting or legal fees to create or maintain the plan.

An Executive Bonus Plan offers your business a great opportunity to provide select key executives (including, in some cases, yourself as a working owner) and employees, valuable life insurance coverage with tax-deferred cash value accumulation.

The Issue of Control

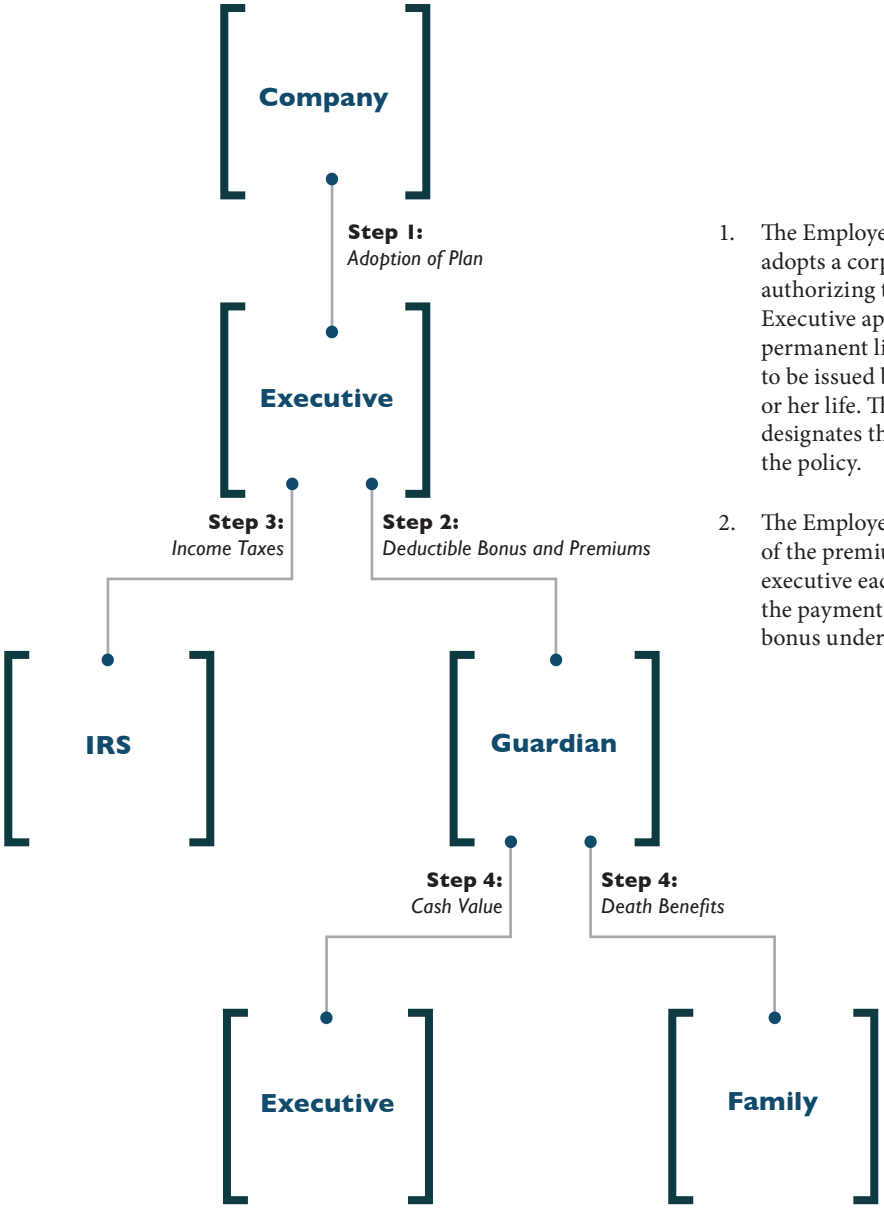
The executive's ownership of the life insurance policy used to fund the Executive Bonus Plan is important for several reasons. First, the executive may take withdrawals and/or loans from the policy's cash value during his or her retirement to supplement retirement income. Unlike other benefit programs, the employee is not reliant upon the employer for payment of the retirement benefit. Also, executive ownership of the life insurance means that it is not subject to the claims of the company's creditors.

From the employer's perspective, employee ownership of the life insurance is also beneficial as it allows the employer to take current tax deductions of the bonus amount each year it is paid for the life insurance premiums, and it eliminates the need for the company to plan for and pay the benefits at retirement.

If the employer has concerns that the Executive Bonus Plan gives the employee too much control, there is a simple solution: a side agreement between the parties that prohibits the employee from accessing the policy cash values or surrendering the contract without the employer's permission. This arrangement is known as a Restricted Executive Bonus Plan. The side agreement provides the business with greater control and delays the executive's access to the policy's cash values, in effect, placing Golden Handcuffs on the executive and tying the executive to the business. Guardian's Select Security Rider helps to provide additional security for this arrangement[2]. The arrangement will still allow an immediate income tax-free death benefit to the executive's beneficiaries upon the executive's death.

[1] Employee Retirement Income Security Act of 1974 ("ERISA") was enacted to protect the interests of participants of employee benefit plans and their beneficiaries. The Act imposes significant plan information and financial disclosure requirements to the participants and establishes standards of conduct for employers and plan fiduciaries. Regulatory and legal remedies are also provided.

[2] The Select Security Rider is permanently unavailable in New Jersey, Oregon, and the state of Washington.



1. The Employer, if a corporation, adopts a corporate resolution authorizing the bonus. The Executive applies for the permanent life insurance policy to be issued by Guardian on his or her life. The Executive also designates the beneficiaries of the policy.

2. The Employer pays all or a portion of the premium on behalf of the executive each year, and treats the payment as a tax-deductible bonus under IRC Section 162[3] .

3. The Executive pays income taxes on the bonus and enjoys full ownership of the policy. The business may even provide additional funds to the executive to cover the executive's income tax liability on the bonus (known as a "Double Bonus Plan").

4. The Executive may access the policy's cash values to supplement retirement income[4]. The death benefits from the policy provide financial protection to the executive's family.

[3] IRC Section 162 requires compensation to be "reasonable" in order for it to be tax-deductible to the business.

[4] The policy owner may access the living benefits of the insurance policy in a number of ways (the tax results assume the policy is not a Modified Endowment Contract) including:

- Dividends in cash. This will be received income tax-free until the owner recovers basis. Thereafter, the dividend is received as ordinary income.
- Surrendering cash value of paid-up additions. These funds will be received income tax free up to the policy owner's basis. Further surrenders will result in ordinary income.
- Borrowing against the contract. Loans are received income tax-free. Interest is due on the loan (but is paid by either cash, policy dividends, surrender of additions or by borrowing the interest). Repayment of the loan is due upon the death of the insured (thereby reducing the total death benefit paid to the beneficiary). A loan affects a dividend positively or negatively on the loaned portion of the policy. In addition, repayment is required where the policy is surrendered in total. At such surrender, tax may be due depending on the policy owner's basis and total cash value.

If the policy lapses with a loan, the outstanding loan amount is considered cash received and may be taxable depending on the taxpayer's basis.

Benefits to the Employer

Recruit, Retain and Reward Key Employees

Since the bonuses are given to select employees, the employer can show those selected how much they are valued and thereby motivate them. It also can help to recruit new employees. The bonus may be used as a reward for any number of reasons — hard work, bringing in new clients, product innovation, or other activities that increase the company's profitability. It also can reward loyalty and encourage the employee to stay with the company. By using the bonus to purchase permanent life insurance, the employer is directing that this reward be used to provide much needed protection for the executive's family as well as helping to supplement retirement income. These are benefits that most executives want but may have postponed or neglected to address.

Immediate Tax Deduction

The employer receives an immediate tax deduction for the bonus that is given to the executive.

Selective Participation

The employer is completely free to choose which executives will be given bonuses. Additionally, the employer may vary the amount of bonus given to each executive.

Simplicity

An Executive Bonus Plan is the simplest type of executive benefit plan. A bonus is simply additional compensation given to an employee as a reward for a job well done. The component that distinguishes an Executive Bonus Plan from other bonus programs is two-fold: the money is used to purchase a permanent life insurance policy that builds cash value and is owned by the executive, and the plan can allow for a "golden handcuffs" of the executive. The executive only pays the income tax due on the bonus. If the employer chooses, the executive may be given a "Double Bonus" which means that the bonus equals the sum of the premium plus the tax due on the bonus. Thus, the executive could have no "out of pocket" cost for the life insurance.

Golden Handcuffs

If the employer wishes, a side agreement, used in conjunction with the Select Security Rider that is added to the Guardian policy, can restrict the executive's access to the policy's cash value for an agreed upon period of time. This serves to tie the executive to the company. This would be difficult to accomplish if the bonus did not involve the use of a permanent life insurance policy.

Minimal Administration

Documentation for the plan is straightforward. A corporate resolution authorizing the plan should be included in the corporate minutes, if the employer is a corporation. Neither ERISA reporting nor IRS qualification is required.

Benefits to the Executive

Wealth Accumulation

The executive is entitled to the cash value that grows tax deferred along with an income tax-free death benefit payable to the executive's beneficiary. These tax advantages are due to the special tax treatment that life insurance receives under federal tax laws. Also, if a trust owns the policy, it is possible that death benefits from the insurance contract may be estate tax-free (assuming the insured possessed no ownership rights in the policy at death or transferred ownership rights more than three years before death). This provides valuable protection to the family against the executive's premature death.

Retirement Options

The cash value and death benefit can help provide the executive and his or her family with supplemental income. Money can be accessed from the policy cash values in a tax-favored manner to supplement an executive's retirement. A beneficiary can also receive death proceeds as a lump sum or choose from several settlement options.

Affordable Life Insurance

The executive's cost for the insurance is reduced by the amount of the employer's bonus. The tax on the bonus can be offset by a larger bonus or use of the policy values. The savings on the cost of the insurance frees up personal funds that would otherwise be spent on the life insurance.

Control

The executive is both the insured and the owner of the life insurance policy. The executive chooses the beneficiary of the policy. (The policy may also be owned by a trust that is established by the executive. As noted above, this can assist in estate tax planning.) This plan is, therefore, portable.

No Qualified Plan Restriction

The penalties for premature distributions before age 59 1/2 and the minimum distribution requirements after age 70 1/2 that apply to qualified retirement plans do not apply to Executive Bonus Plans.

The Strength of Guardian

The Guardian Life Insurance Company of America, a mutual company owned by its policyholders, was founded in 1860. Since that time, Guardian has maintained a solid reputation for building long-term relationships with its clients, helping them realize their financial goals.

Guardian is one of the nation's oldest and most respected insurers, and ranks among the top mutual companies measured by assets in the nation today[5]. Guardian's unique surplus position and high-quality investment portfolio have enabled the company to consistently earn high yields. This is reflected in our strong dividend history, the envy of the insurance industry. Dividends are not guaranteed, and Guardian can't predict that future results will match those of the past, but the company has paid dividends to policyowners every year since 1868. Guardian policyowners have continually received a substantial return of premium through dividends, high cash accumulations and insurance benefits for their families and businesses.

[5] Financial information concerning The Guardian Life Insurance Company of America as of 12/31/08 on a statutory basis: Admitted Assets = $29.0 Billion; Liabilities = $25.3 Billion (including $22.1 Billion of Reserves); and Surplus = $3.7 Billion.

Conclusion

If you're looking for a simple, yet effective and cost efficient method to recruit, retain and reward your selected executives and key employees, and perhaps a method to use business dollars to fund your own protection and retirement objectives, consult with your Guardian financial representative to see how an Executive Bonus Plan can help.

About Guardian

Our company serves individuals, businesses, and their employees through our products and services, expert advice and vision. The financial solutions we provide are backed by our company's solid reputation and focus on the long term.

When choosing a financial provider, it's important to look to the history and core values that form a company's foundation. Since 1860, Guardian has been committed to protecting clients so they can enjoy the freedom from worry and uncertainty, and capitalize on the freedom to live life to its fullest. The relationships we forge are guided by the values that govern all the decisions we make: we do the right thing, people count, and we hold ourselves to very high standards.

At Guardian, we take great pride in providing solutions to help businesses and individuals build their financial security and protect what they value most. It is our privilege to serve you.

GUARDIAN®

The Guardian Life Insurance Company of America
7 Hanover Square
New York, NY 10004-4025
www.GuardianLife.com

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