SECTION 162 EXECUTIVE BONUS PLAN

Providing for Key Employees

With the onerous deferred compensation rules contained in Internal Revenue Code Section 409A along with the lack of tax deductions in funding, many employers are turning to Section 162 Executive Bonus Plans to provide for key employees. An executive bonus plan is a way to provide additional benefits to key employees while being able to discriminate as to who receives the benefits. With a Section 162 Executive Bonus Plan, the employer pays either the employee or the insurance company directly a bonus amount in the form of a premium for a life insurance or annuity policy. The employer determines who can be a part of the plan, how much to contribute, and whether they prefer a life insurance policy or a deferred annuity.

Implementation

Employer

The employer must determine what they are trying to accomplish when creating and designing an executive bonus plan. Once they decide how much they are willing to pay as premium, they can then determine how much coverage is needed. Then, the employer either pays the employee directly or makes premium payments directly to the life insurance/annuity company.

LIFE INSURANCE

If a life insurance policy is chosen, the employee will have a death benefit that completes the plan and a living benefit if the employee chooses to use it as such.

ANNUITY

If an annuity is chosen, the employee obtains tax deferred growth on the money bonused into the annuity policy and will have a benefit at retirement. An annuity allows the employer to vary the annual bonus or even skip a year if business is down.

Employee

The employee applies for and owns the life insurance policy or annuity. They also name the beneficiary.

How Can an Executive Bonus Plan Be Implemented to Retain Key Employees?

Payback Agreement

The employer may enter into a side agreement with the employee that states if the employee leaves the employer's employment prior to a certain specified date, the employee will be required to pay back the bonuses received.

Vesting Schedule

The employer can provide a vesting schedule whereby if the employee leaves the company prior to full vesting, the employee will be required to pay back the unvested amount.

Tax Impact

Under a Section 162 Executive Bonus Plan, the employee takes each year's bonus into taxable income as received or when the premium is paid by the company. Some companies will gross-up or pay an additional bonus for projected income taxes and payroll taxes attributable to the bonus. Since the employee owns the life insurance policy or non-qualified deferred annuity, they will have access to policy values.

The only exception to the bonus being deductible is if the IRS would rule that the employee's total compensation is unreasonable. If that is the case, the employer would be limited in how much they can deduct but the employee would still take all of the compensation into taxable income.[1]

Advantages and Disadvantages

ADVANTAGES TO EACH PARTY	
EMPLOYER	**EXECUTIVE**
• Employer selects which executives they wish to benefit • Employer chooses benefit level and can customize for each executive • 162 Executive Bonus Plan easy to implement and administer • No administration other than regular payroll • Bonuses may be fully deductible to employer under IRC 162 • Rewards and retains Key Employees • Plan can be terminated by company at any time	• Employee owns the policy and policy values • Employee gets to name beneficiaries • Accumulating values can be accessed by employee • Tax-deferred growth on accumulations • Tax-free death benefit in case of life insurance • Life insurance can benefit survivors and pay estate costs • Cash values available for emergencies • Cash values may be used to supplement retirement income

DISADVANTAGES TO EACH PARTY

EMPLOYER	EXECUTIVE
• The company has very little control of the life insurance policy or annuity	• The Key Executive must include the bonus paid in their taxable income • If an annuity is used, an IRS penalty of 10% may apply on withdrawals from annuities prior to age 59½ • Withdrawals from a life insurance policy will impact cash value and death benefit

1) See IRC Regulations.1.162-7(b)(3). Contact your financial and tax advisors to determine if a bonus plan is right for you and your company. All concepts, strategies, and products discussed in this literature may not be suitable for you and your company. Please consult your advisors to determine which strategy is right for your specific circumstances. Information provided is not intended to be legal or tax advice. Neither American National nor its representatives provide legal or tax advice. Please consult your attorney or tax advisor for your specific situation. Clients should contact their attorney or tax advisor on their specific situation. American National Insurance Company, Galveston, Texas. American National Life Insurance Company of New York, Glenmont, New York. Each company has financial responsibility only for the products and services it issues.

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10278-162 | 08.21