

Tax Break for Small Business

Section 162 Executive Bonus Plan

Small businesses can reward key executives with this simple-to-administer, tax-deductible benefit.

This bonus plan benefits both the employer and key executives: The employer gets a tax deduction, and the executive gets life insurance protection. The employer has complete freedom to select the executive(s) to be covered by the plan and the amount(s) of insurance to be provided. The executive owns the policy and the cash value that accumulates over the years.



This non-salary compensation for executives is made possible by Section 162(a)(1) of the Internal Revenue Code, but it requires no special IRS approval. The plan is easy to set up and administer—a big plus for small businesses.*

To set up a plan, the company and executive enter into a written agreement that specifies what each party will do and how each will benefit, as outlined in the following steps:

The Company

1. *The company pays a bonus to the executive.*

- The company may pay the executive directly or remit the premium payment directly to the life insurance company through a payroll deduction agreement.
- The amount of the premium is additional compensation to the executive (subject to "reasonable compensation" rules).
- The employer may include in the bonus enough money to cover both the insurance premium and the tax the executive will pay on this taxable income.

2. *The company takes a tax deduction.*

- Note that generally this plan yields a net benefit to the employer and executive(s)—who in small businesses are often the same people—when the company's marginal tax bracket is greater than that of the selected executive(s). When this is the case, the total benefit (bonus amount) will be greater than the total cost (premium minus tax deduction plus tax on the bonus).
- Otherwise, the cost will usually be greater than the benefit. However, many business owners still elect to use this method of buying life insurance for themselves and key executives because they want the business to pay the premium.

The Executive

1. *The executive uses the bonus to purchase a life insurance policy.*

- The executive chooses the beneficiary. The company may not be the beneficiary.
- The executive is the owner of the policy, so if the executive leaves the company and wants to keep the policy in force, he or she is responsible to pay premiums.

2. *The executive pays tax on the bonus.*

3. *The executive and his family benefit from the policy.*

- While alive, the executive may choose to receive cash values from the policy (cash withdrawals may affect the death benefit).
- When the executive dies, his or her beneficiaries receive the available death benefit.

Please feel free to contact me. I would be happy to answer any questions regarding the worth or effectiveness of your current insurance programs.

The purpose of this newsletter is to provide information of general interest to our clients, potential clients and other professionals. The information provided is general in nature and should not be considered complete information on any product or concept described. This newsletter should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professionals. Presented by: **Victor Posod, Circa Benefits Insurance Agency**