Small-Business Life Insurance Kit

(R-11/2013)

Allianz Life Insurance Company of North America

Executive **bonus plans**

Reward and motivate key employees and get a tax deduction for your business

Bonus plan basics

Section 162(a)(1) of the Internal Revenue Code allows businesses a tax deduction for salaries or other compensation as a "reasonable allowance for personal services actually rendered."

EXECUTIVE BONUSES are generally tax-deductible by the employer.

Certain executive bonuses are included in this definition of "reasonable compensation," which is why they're sometimes called Section 162 executive bonus plans.

Such bonuses are generally deductible by an employer according to the same rules as other forms of cash compensation – although no deduction is generally allowed for compensation in excess of $1 million for publicly traded companies when the employee is the CEO or among the four highest compensated officers as defined in IRC section 162(m).

Structuring a bonus plan to buy life insurance for employees

Many businesses choose to pay their bonuses in cash, but you might consider offering your key people other choices. One option could involve using part – or all – of their bonus to purchase life insurance.

Here's how it works:

Under the executive bonus plan, the employee purchases (and owns) a fixed index universal life (FIUL) insurance policy. The employer then uses the bonus to pay the entire policy premium directly to the insurance company.

The premium payment is reported in box 1 on the employee's W-2 statement. (This compensation is subject to Social Security (FICA) taxes if the employee's pay is below the FICA wage base, as well as Federal Unemployment (FUTA) tax.) Because the bonus is reported as compensation, you can deduct it as a business expense to the extent permitted under Section 162 (there are limits to deduction of compensation for certain executives).

Since life insurance is an underwritten product, any strategy that includes it is contingent on the health underwriting of the insured and, in some cases, financial underwriting.

What if the business just buys a life insurance policy without a bonus plan?

If an employer buys any interest in an individual life insurance policy on an employee, the premiums **would not be tax-deductible.** (Life insurance premium is a tax-deductible business expense when group term life insurance is purchased for all qualified employees.)

By contrast, when your employee uses a bonus to buy a life insurance policy, as explained above, the premium can be tax-deductible for your business, since it's considered compensation.

For all that's ahead.®

Allianz

Must be accompanied by the Small-Business Life Insurance Kit consumer brochure (M-5101).

Product and feature availability may vary by state.

M-5105

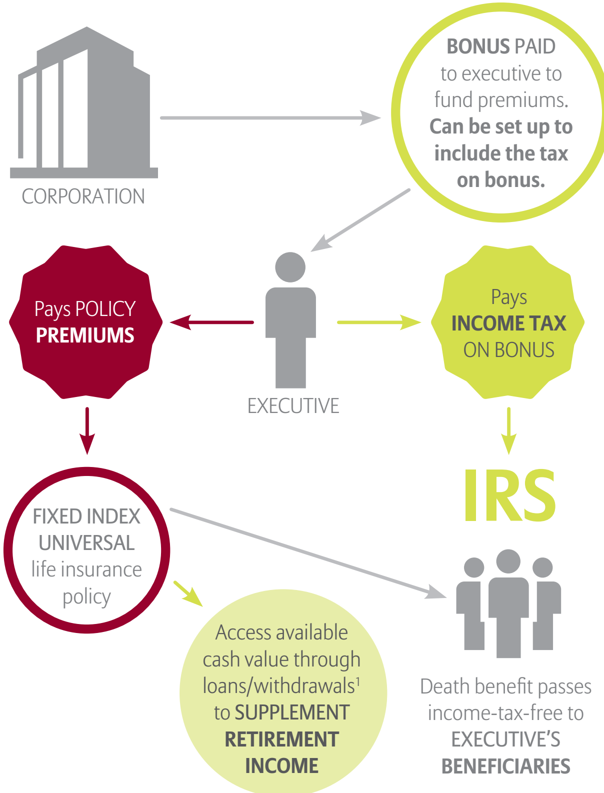
Let's take a look at a hypothetical executive bonus scenario

The owner of a company, ABC Inc., decides to give its key employee, John, an annual bonus.

John receives an annual bonus of $50,000 from ABC Inc. and uses $15,000 to pay his income taxes.

With the remaining $35,000 per year, John buys an Allianz Life Pro+® Fixed Index Universal Life Insurance Policy. The $35,000 represents the target annual premium of $16,553 plus the additional premium he plans to pay for 20 years. This allows him to pay additional premium into the policy, while not creating a modified endowment contract (MEC).

John is able to access the available cash value through loans/withdrawals[1] to supplement retirement income.



The result

ABC Inc. can claim a tax deduction for the bonus because it's part of John's compensation and will be taxed to him.[4] John gets valuable life insurance protection and if the need arises, can also use his policy to help supplement his retirement income at age 65 through policy loans.[1] Because he uses his bonus to buy life insurance, John is the policy's owner.

In this hypothetical example, by taking policy loans, John would have the potential to supplement his income in the amount of $111,698 for 20 years at age 66, based on a 7% assumed interest rate. If properly structured, John's annual income after age 65 could be income-tax-free.

Target annual premium	$16,553	
Planned annual premium to age 65	$35,000	
Income at age 66, 7% illustrated rate	$111,698[1]	
	7% ASSUMED INTEREST RATE[2]	**1.5% MINIMUM GUARANTEE[3]**
Cash value at age 65	$1,233,010	$546,523
Death benefit at age 65	$2,233,010	$1,546,523
Death benefit at age 85	$843,547	At age 69, policy lapses

Assumptions: Male, age 45, Standard Nontobacco risk class, an initial death benefit of $1,000,000 (death benefit option B), and 7% illustrated rate.

This hypothetical example is provided for illustrative purposes only. The character is fictional and not an actual Allianz client.

[1] **Policy loans and withdrawals will reduce available cash values and death benefits, and may cause the policy to lapse or affect any guarantees against lapse. Additional premium payments may be required to keep the policy in force. In event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to change and you should consult a tax professional.**

Policy loans are not usually subject to income tax unless the policy is classified as a modified endowment contract (MEC) under IRC Section 7702A. However, withdrawals or partial surrenders from a non-MEC policy are subject to income tax to the extent that the amount distributed exceeds the owner's cost basis in the policy. Loans, withdrawals, or partial surrenders from a MEC policy are subject to income tax to the extent of any gains in the policy, and if the payment occurs prior to age 59½, a 10% federal additional tax may apply.

[2] Based on historical performance, the index allocation options available would have returned a wide range of returns. Some would have exceeded 7.00% and some would have been less than this. Keep in mind that different time periods and different indexes will produce higher or lower averages. The rate of return is based on the caps or participation rates in the policy and is subject to change on any policy anniversary based on several external factors including, but not limited to, market volatility, short-term interest rates, and long term interest yields. See the contract for more details.

[3] Assumes a guaranteed interest rate of 1.5%, guaranteed maximum premium charges, maximum expense charges, maximum cost of insurance rates, and credited bonuses, if applicable.

[4] For more information on the tax implications of contributions to or distributions from this or any other employee benefit plan, you should consult your attorney or tax advisor.

Executive bonus plans help your employees feel valued and appreciated.

If the executive bonus is used to purchase life insurance for your employee, it can also offer other tangible benefits by:

- Providing an income-tax-free death benefit for their beneficiaries
- Becoming a potential source of tax-free supplemental retirement income through loans or withdrawals from any available cash value[1]

But executive bonus plans can also benefit you.

In addition to the tax advantages described above, an executive bonus plan can help your business attract and keep top talent. And remember that, as a business owner, you can set up an executive bonus plan for yourself, too – so you can enjoy the same tangible benefits as your employees.

Executive bonus plans are straight forward to set up.

There are no government reporting costs, and a written agreement is usually not required because the executive owns the policy, and the employer has no rights or benefits in the policy.

Executive bonus plans are also flexible. You can decide who will receive this benefit and in what amount. You can tie the bonus to company performance or to individual goals, and you can start or discontinue an executive bonus plan at any time. The bonus paid to the executive can also be set up to include the tax incurred on the bonus.

However, you should consult with an attorney and an accountant before you set up an executive bonus plan.

Can an executive bonus plan be appropriate for your business?
Call your financial professional today to start the discussion.

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An employer-owned life insurance policy may be subject to the requirements of Internal Revenue Code 101(j) in order to obtain an income-tax-free death benefit. In general those rules require that before the policy is issued, the employer must provide the insured with a written notice of the life insurance and obtain a written consent from the insured. Consult with an attorney for application of those rules to a specific situation. Tax laws are subject to change and you should consult your tax professional.

This piece is designed to provide general information on the subjects covered. Pursuant to IRS Circular 230, it is not, however, intended to provide specific legal or tax advice and cannot be used to avoid tax penalties or to promote, market, or recommend any tax plan or arrangement. Please note that Allianz Life Insurance Company of North America, its affiliated companies, and their representatives and employees do not give legal or tax advice. You are encouraged to consult your tax advisor or attorney.

Consult an attorney to determine whether your executive bonus plan is subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

True to our promises … so you can be true to yours.®

A leading provider of annuities and life insurance, Allianz Life Insurance Company of North America (Allianz) bases each decision on a philosophy of being true: **True to our strength** as an important part of a leading global financial organization. **True to our passion** for making wise investment decisions. And **true to the people we serve**, each and every day.

Through a line of innovative products and a network of trusted financial professionals, and with over 2.6 million contracts issued, Allianz helps people as they seek to achieve their financial and retirement goals. Founded in 1896, Allianz is proud to play a vital role in the success of our global parent, Allianz SE, one of the world's largest financial services companies.

While we pride ourselves on our financial strength, we're made of much more than our balance sheet. We believe in making a difference with our clients by being true to our commitments and keeping our promises. People rely on Allianz today and count on us for tomorrow – when they need us most.

Guarantees are backed solely by the financial strength and claims-paying ability of Allianz Life Insurance Company of North America.

Product and feature availability may vary by state.

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