



Executive Bonus Arrangement

Do you have small business prospects that would like to provide a retirement benefit for their key executives, but do not want, or cannot afford, to provide retirement benefits for all employees? Do they want the fringe benefit to be tax-deductible? If so, the executive bonus arrangement should be considered.

Facts: Manny and Minnie own a local chain of gas stations/convenience stores. Manny and Minnie's Maxi-Marts (MMMM) have a large number of full-time employees earning just over minimum wage. Their son-in-law, Marty, runs the day-to-day corporate operations. Marty has come to them with his concerns about immediate protection for his family, should something happen to him, as well as his need for retirement savings. He wants to know if the business would consider sponsoring a qualified plan.

Manny and Minnie would like to provide Marty a retirement benefit, but they are reluctant to put a qualified plan in place due to the administrative burden. They would like benefit dollars used to reward Marty for his leadership and to protect his family in case something should happen to him. And they would like to make their contributions tax deductible.

Solution: An executive bonus arrangement may be used to provide retirement benefits for Marty, while also providing life insurance on Marty's life for the benefit of his family.

The executive bonus arrangement is very simple to implement and administer. The employee purchases and owns a life insurance policy, naming someone other than the business as the beneficiary. There is an agreement between the business and the employee whereby the business agrees to either pay the premiums directly to the insurance company or to pay a cash bonus to the employee sufficient to allow the employee to pay the premiums. The company is free to select who will receive benefits, and is not bound by the complex system of participation and vesting that governs qualified plans. The premium payment is taxable as income to the employee and tax-deductible to the business as long as the executive's total compensation is considered reasonable.

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Benefits of this arrangement include:

For the Employer:

- Employer can pick and choose which of its employees should be allowed to participate
- Bonus levels can vary from employee to employee
- Bonus is tax-deductible if compensation is reasonable
- Arrangement can be terminated at any time
- No IRS approval
- Easy to implement and minimal administration
- Can provide an incentive for participating employees to stay with the company since future bonuses are contingent on employee continuing to work for the firm

For the Employee:

- Enables executive to buy life insurance protection at a lower out-of-pocket cost than on an individual basis. Out-of-pocket costs could be completely eliminated if employer provides a "double bonus" (enough to pay the premium plus the income tax due on the bonus)
- Policy is portable and can provide life insurance coverage before and after retirement.
- Policy cash values may be accessed to provide tax-favored supplemental retirement income.¹
- At the executive's death, cash is available to replace the executive's income to his/her family, to help liquidate debts, and/or to pay estate taxes and administration costs.

CHART OF CONCEPT ATTACHED

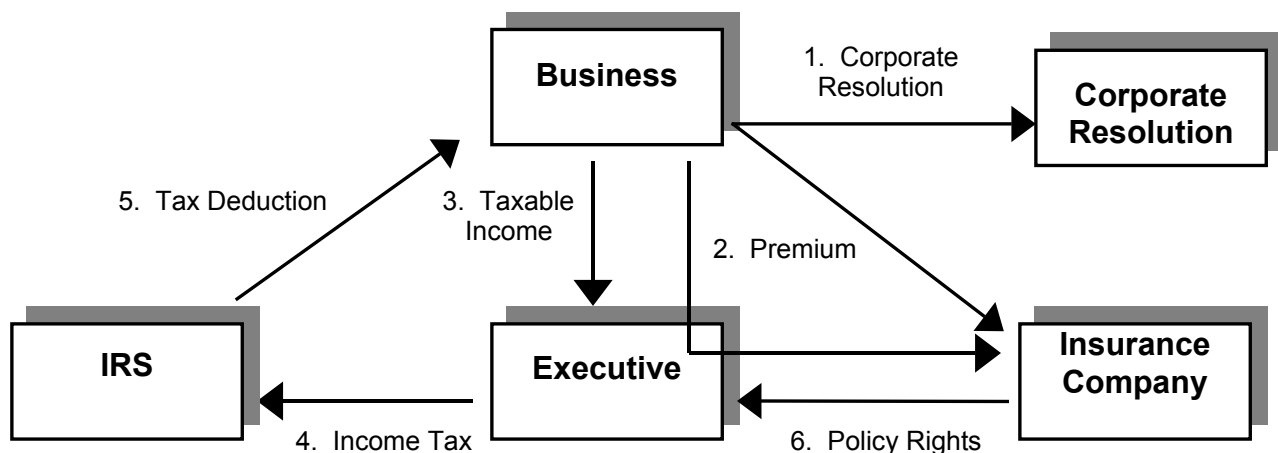
¹ Life insurance policy cash values are accessed through withdrawals and/or policy loans. Loans are at interest. Unpaid loans and/or withdrawals cause a reduction in policy cash values and death benefits and may affect any policy guarantees against lapse. In general, loans are not taxable, but withdrawals are taxable to the extent they exceed basis in the contract. Loans outstanding at policy lapse or surrender occurring prior to the death of the insured and that exceed the policy's cost basis will cause immediate taxation to the extent of gain in the contract. For policies that are Modified Endowment Contracts, distributions (including loans and withdrawals) will be taxed to the extent of policy earnings. There may be an additional 10% federal income tax penalty for taxable distributions prior to age 59½. Consult your tax advisor for advice regarding your particular situation. A policy's illustrated cash value consists of both guaranteed and nonguaranteed values. Nonguaranteed values may include dividends or earnings, which are not guaranteed and will change.

QUESTIONS? CALL ADVANCED MARKETING

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The Structure of an Executive Bonus Arrangement



1. The business notifies the participants of its intention to establish an executive bonus arrangement and, if applicable, adopts a corporate resolution.
2. The business pays a bonus to the executive who then pays premiums to the insurance company for a policy he/she generally owns. Alternatively, the business may decide to pay the premium directly to the insurance company.
3. The bonused amount is included in the executive's gross income for the current year.
4. The executive reports the bonused income and remits the appropriate tax.
5. The business receives a tax deduction in the year the bonus is included in the executive's income.
6. The executive has full policy ownership rights, including the right to any policy values, the right to name a personal beneficiary, and the right to name a third party, such as a trust, as policy owner.