

# Restricted executive **bonus** **arrangement**

Keeping your best people in your business

## An effective way to reward and retain your best employees

Businesses like yours typically rely on the services of just a few key people to maintain success and viability. These key people deserve and even expect to be rewarded appropriately for their hard work.

As the business owner, you may also wish to provide these valuable employees with a special benefit to reduce temptations to leave for the competition.

With a restricted executive bonus arrangement (REBA), you can reward these employees in a way that builds loyalty to your business and can help them once they retire – without the complexities of some nonqualified plans.

### **A REBA is an employee bonus arrangement that is funded by the employer.**

It consists of a life insurance policy that is subject to certain restrictions:

- The employee is the insured, owns the life insurance policy, and names a beneficiary.

- The employee cannot access any available cash value without the employer's consent.
- If the employee leaves the business, the employee may be required to pay back to the employer all or part of the bonuses that are used to fund the life insurance policy.
- If the employee remains with the business until a predetermined date, the restriction on the policy will be lifted.

With a REBA, you can create a “golden handcuff” that may help build loyalty to your business and provides the employee with a benefit in the form of a cash value life insurance policy. Keep in mind that most life insurance policies require health underwriting and, in some cases, financial underwriting.

For all that's ahead.®

**Allianz** 

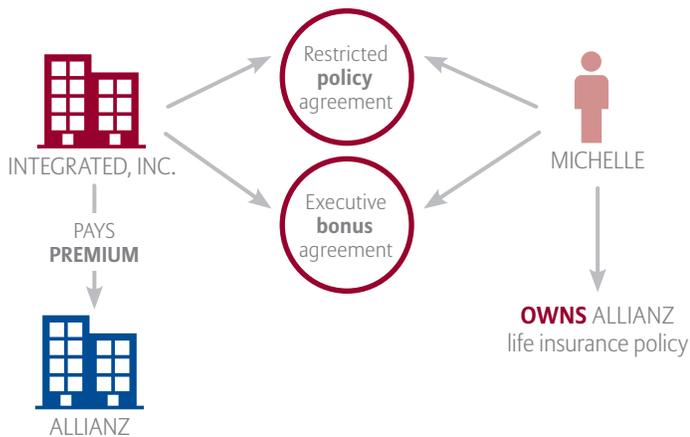
## A hypothetical example of a small-business REBA

A small computer consulting firm, Integrated Technology, Inc. (Integrated), is owned 100% by Charles.

A few years ago, Charles hired a creative computer analyst, Michelle, to help develop their online specialties. Since that time, Michelle has become the main technical wizard at Integrated.

She has had other job offers, as Charles knows, and even though Michelle has been loyal to Charles and his company, Charles is very concerned that he could lose Michelle to the competition.

As a special employee benefit, Charles provides Michelle with a REBA. Here's how it works:



1. Integrated pays Michelle a bonus of \$50,000, and she uses \$15,000 to pay income taxes. She uses the remaining \$35,000 to pay annual premium into an Allianz Life Pro+® Fixed Index Universal Life Insurance Policy. Or, for convenience purposes, Integrated pays the \$35,000 premium on the policy directly to Allianz on behalf of Michelle.
2. Michelle is named the owner of an Allianz Life Pro+ Fixed Index Universal Life Insurance Policy, insuring her life, and she names the beneficiary/ies of the policy.
3. The REBA requires two documents signed by the employer and the employee:
  - a. An *executive bonus agreement* that's drafted by the employee's or employer's attorney and includes details on the bonus, restriction, repayment guidelines, termination date, etc.
  - b. A *restricted policy agreement* that restricts employee's access to the available cash value until a predetermined date when the restriction terminates or unless the employer approves.
4. Integrated continues to make annual \$35,000 premium payments on behalf of Michelle while she remains employed with Integrated, as agreed upon by Michelle and Integrated. Michelle is taxed annually on those premiums as a bonus.<sup>4</sup>
5. If Michelle works at Integrated until the applicable predetermined date, the restriction is lifted, and she then has entire control of the life insurance policy.
6. If Michelle quits working at Integrated before the applicable predetermined date, she may owe back some or all of the premium bonuses used to fund a life insurance policy.
7. If Michelle dies while the life insurance policy is in force, her chosen beneficiaries receive the death benefit on the policy.

Target annual premium	\$14,026	
Planned annual premium to age 65	\$35,000	
Income at age 66, 7% illustrated rate	\$119,608 <sup>1</sup>	
	<b>7% ASSUMED INTEREST RATE<sup>2</sup></b>	<b>1.5% MINIMUM GUARANTEE<sup>3</sup></b>
Cash value at age 65	\$1,294,971	\$592,887
Death benefit at age 65	\$2,294,971	\$1,592,887
Death benefit at age 85	\$858,250	At age 70, policy lapses

Assumptions: Female, age 45, Preferred Nontobacco risk class, an initial death benefit of \$3,287,882 (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.

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> 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.

<sup>4</sup> 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.

## The result

Integrated can claim a tax deduction for the bonus because it's part of Michelle's compensation and will be taxed to her. She gets valuable life insurance protection and can also use her policy to help supplement her retirement income at age 65 through policy loans.<sup>1</sup> Because she uses her bonus to buy life insurance, Michelle is the policy's owner.

In this hypothetical example, by taking policy loans, Michelle would have the potential to supplement her income in the amount of \$119,608 for 20 years at age 66, based on a 7% assumed interest rate.<sup>1</sup> If properly structured, Michelle's annual income after age 65 could be income-tax-free.<sup>2</sup>

## Benefits of a REBA

- Allows you to select which employees you wish to reward
- Rewards the key employee for services rendered to the business
- Builds loyalty to the business – creates a golden handcuff
- Offers a potential income tax deduction to the employer
- Provides the employee's family with a death benefit if the employee dies
- Provides the employee with ownership of a cash value life insurance policy with potential access to the available cash value via policy loans upon a given date<sup>1</sup>

## Limitations of a REBA

- The employer does not have ownership of or any rights to the life insurance policy
- Employee has currently taxed income equal to the premiums paid
- Employee has to obtain employer's consent to access any available cash value
- Costs of hiring an attorney to draft the legal document – in some cases, the special rules of IRC Section 409A may apply
- Costs of purchasing the life insurance policy
- Not available if the employee is uninsurable

You should consult with your own tax and legal advisors for the tax and legal ramifications of using this employee benefit.

**Talk to your financial professional**  
about how life insurance can be used  
with the REBA concept to build loyalty  
and reward employees.

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

<sup>1</sup> 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.

<sup>2</sup> 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.

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.

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

The Employee Retirement Income Security Act (ERISA) may apply. Be sure to consult your tax advisor or attorney regarding your own situation.



# 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.

[www.allianzlife.com](http://www.allianzlife.com)

Products are issued by:

Allianz Life Insurance Company

of North America

PO Box 59060

Minneapolis, MN 55459-0060

800.950.1962

P54350  
(R-11/2013)