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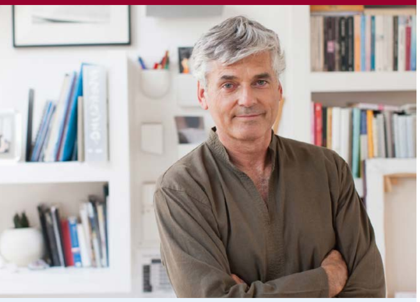
Keeping your competitive edge

Executive bonus plan: a business protection strategy to retain top talent

CASE STUDY



Meet Phil

Owner of Packaging in Action, a closely held family business

Phil has been in business for more than 25 years. He's got a top-notch plant manager, Greg, age 45. Greg is an innovator who helps the firm keep its leading edge and maintain a healthy profit margin.

Because Phil doesn't want to lose Greg to a competitor, he wants to reward him with a benefit that will encourage him to stay employed at Packaging in Action for the rest of his career.

Phil's challenge

He wants a benefit that may provide Greg with:

- A significant future retirement benefit
- An attractive benefit for today

And he wants a benefit that may provide Packaging in Action with:

- A simple way for the business to reward and retain employees
- A tax reduction for the business
- Ease of implementation and administration

As a business owner, you understand that one of your most valuable assets is the creative talent of your key employees. Your competitors also understand this and compete for the very same talent. You need a protection strategy that will give your key team members a strong incentive to remain employed at your organization.

One way of managing this challenge is to offer an attractive compensation package. But salary alone may not be enough. An executive bonus plan (also known as a Section 162 bonus plan) may provide a simple solution. These plans are designed to help you attract and retain key employees.

How an executive bonus plan works

- You decide who participates. Unlike qualified plans, you have total discretion regarding which employees to include in the plan.
- Your selected employee purchases a life insurance policy, and the employee is now the owner of the policy and names his beneficiary.
- The premium is paid by the company and is typically made directly to the insurance company. The premium is treated as a "bonus" to the employee, and it will be taxed as ordinary income to the employee.
- The company can generally take a current tax reduction for any annual bonuses paid.[1]
- There are many design options. You might simply choose to bonus the premium paid. Or you may decide to "double bonus" the employee, providing the initial bonus (premium) and taxes due on the bonus.

How it continues once in place

As you continue to make the premium payments, your key employee now has the incentive to remain actively employed with your business and enjoy the benefits of:

- Policy ownership
- Living benefits, including tax-deferred cash value growth and advantaged access to cash through policy loans and withdrawals for retirement income,[2] college planning, or an unexpected life event
- Income tax-free death benefit for their beneficiaries

Not a deposit	Not FDIC-insured	May go down in value
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Insurance products issued by:
The Lincoln National Life Insurance Company

A strategy with flexibility

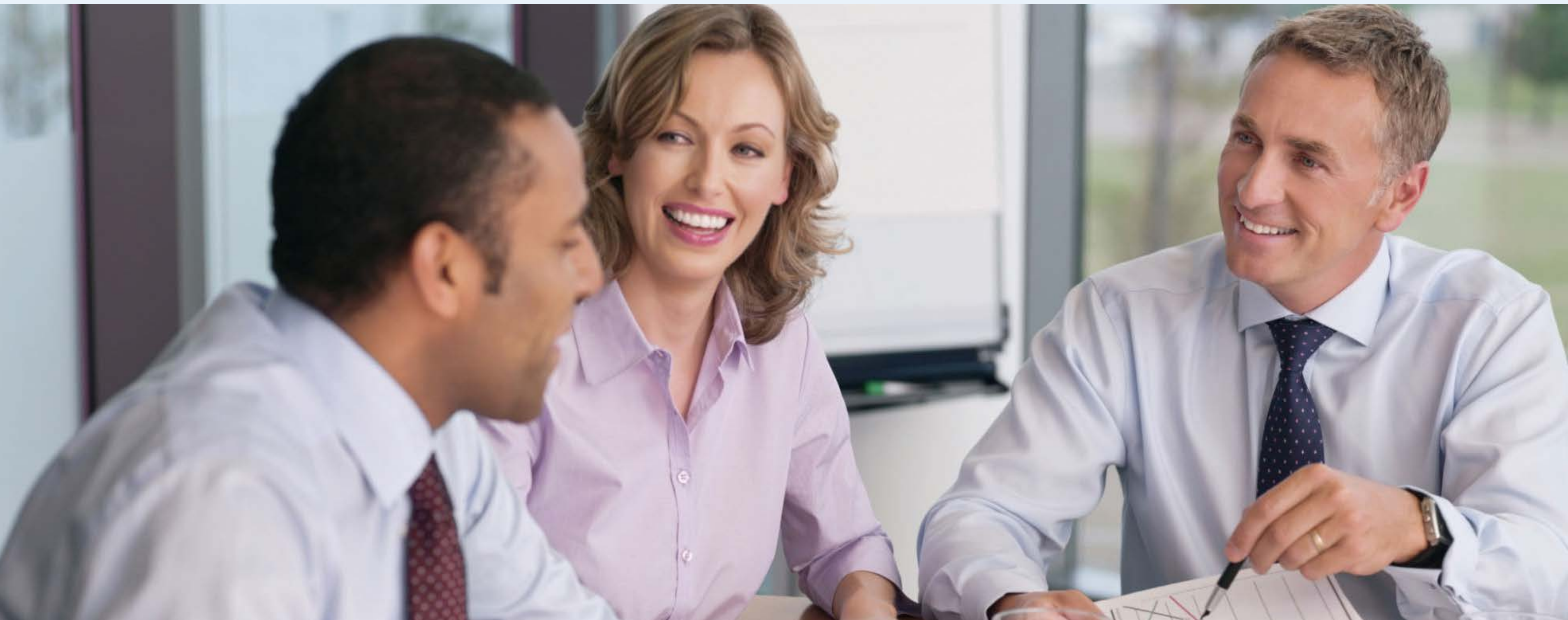
To help ensure that Packaging in Action keeps key talent like Greg, Phil's advisor recommends an executive bonus plan using life insurance. The strategy gives Phil's corporation a cost-efficient way to provide Greg an attractive benefit package with added advantages. Packaging in Action agrees to pay a tax-deductible bonus in the amount of $10,000 annually for a life insurance premium where Greg will be both the insured and policyowner.[1]

An accumulation indexed universal life (IUL) policy is purchased on Greg's life. Greg names his wife, Karen, as the policy beneficiary. In addition to valuable death benefit protection, an accumulation IUL can offer growth and cash value distribution potential, which can supplement Greg's retirement income.[2] If available, Greg can get added protection by choosing an accelerated benefit rider as a source of supplemental funds if he develops a permanent chronic or terminal illness.[3]

IUL policies offer features important to Phil and Greg, including

- Policy values not directly invested in the market, so Greg would be protected from negative returns caused by market downturns[4]
- Indexed accounts tied to stock market performance (excluding dividends) — providing access to market opportunity and varying levels of protection to meet client needs and preferences
- Loan strategies that can provide access to cash value for needs throughout Greg's life[2]

Some IULs offer options for living benefits that provide a source of supplemental funds if Greg develops a permanent chronic or terminal illness.



The advantages for Greg

- Greg owns the policy and gets to name his beneficiary.
- He has access to living benefits[3] and an income tax-free death benefit for Karen.
- He has significant tax-deferred growth opportunities to create a financial resource for his future.
- When properly designed, there are no required distributions at age 70½ and no early withdrawal penalties before age 59½.
- His only out-of-pocket expense is the cost of the taxes paid on the bonuses he received.

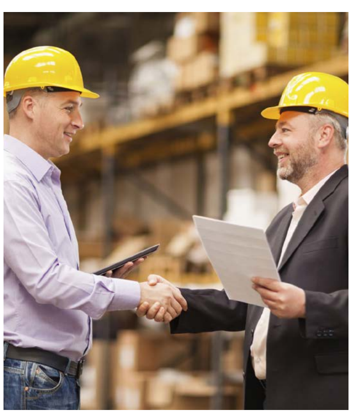
Total out-of-pocket expense over 20 years to pay taxes on his bonus	–$64,000*
Cumulative policy loans taken income tax-free to supplement Greg's retirement from ages 66 to 85	+$936,640
Greg's death benefit at age 85	+$421,772
Net benefit to Greg at age 85	**$1,294,412**

*Greg's assumed tax rate is 32%. Packaging in Action assumed tax rate is 21%.

The hypothetical example assumes a male, age 45, standard nontobacco, *Lincoln WealthAccumulate*® IUL, solve for a minimum non-MEC death benefit with a $10,000 annual premium paid for 20 years, increasing by cash value death benefit option for 20 years then switch to a level death benefit option, solve for maximum annualized participating loans from ages 66 through 85 with $1 at maturity. 100% premium allocation to Perform Plus Indexed Account, 6.90% assumed index crediting. **At 0% guaranteed interest crediting and maximum annualized policy loans beginning at age 66, policy lapses at age 67.**

The advantages for the business

- Packaging in Action retains a valuable key employee with an attractive benefit that provides financial protection and a retirement supplement.
- The executive bonus plan is easy to establish and administer, and there's no IRS approval needed.
- Phil can choose which employees he wants to reward, and his business will have a current tax reduction for the bonus paid.[1]
- When properly structured, the plan is flexible and cost-effective.



Bonus paid per year	$10,000
Current tax reduction for bonus paid per year[1,5]	$2,100
Total bonus paid to Greg to age 65	**$200,000**
Total tax reductions for bonuses paid[1]	**–$42,000**
Total after-tax cost of the benefit[1]	**$158,000**

Strengthen and protect the future of your business

Ask your financial professional how Lincoln Business Insurance Solutions can help you succeed.

[1] The deductibility of the bonus is subject to the reasonable compensation limits established by Internal Revenue Code Section 162(a).

[2] Distributions are taken through loans and withdrawals, which reduce your policy's cash surrender value and death benefit and may cause the policy to lapse. Loans are not considered income and are tax-free. Withdrawals and surrenders are tax-free up to your cost basis, provided your policy is not a modified endowment contract (MEC). A MEC policy is one in which the life insurance limits exceed certain high levels of premium or the cumulative premium payments exceed certain amounts specified under the Internal Revenue Code. For policies that are MECs, distributions during the life of the insured, including loans, are first treated as taxable to the extent of income in the contract, and an additional 10% federal income tax may apply for withdrawals made prior to age 59½.

[3] Subject to certain requirements and availability. Accelerated death benefits may be taxable and may affect public assistance eligibility. Other account values are reduced proportionately with each acceleration payment. Only one accelerated death benefit is allowed per policy.

[4] Policy charges remain in effect and could reduce your policy value.

[5] Assuming a 21% C-corp tax bracket.

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