Employer Guide
Business Planning

Advanced Markets

Executive Bonus Plans and Restricted Endorsement Bonus Arrangements

In today's increasingly competitive business environment you may be looking for new ideas to attract, retain, and reward talented employees. What's more, employees today are looking for holistic rewards packages, beyond just cash compensation.

Would you like to offer a valuable benefit to select top employees that is cost-effective, simple to implement and administer, and encourages the employee to stay with the business long term? If so, you may want to consider an Executive Bonus Plan or a Restricted Endorsement Bonus Arrangement (REBA).

The value of permanent life insurance

Under an Executive Bonus Plan or REBA, the employee owns a life insurance policy and your business pays the premiums as an additional benefit.

Consider the ways permanent life insurance can benefit the key employee and his/her family:

- **Income tax-free death benefit:** Provides valuable protection to the employee's family[1]
- **Tax-deferred growth:** Cash value grows tax-deferred
- **Income tax-free access:** Cash value can be accessed to supplement retirement income[2]
- **Not subject to qualified plan limitations:** No funding limits, RMDs, or penalties for accessing cash value age 59½
- **Optional riders may enhance policy's value:** Adding a rider for long-term care, critical illness, disability and/or Vitality PLUS may increase the value to the employee

The John Hancock Vitality advantage

One in two employees indicate that they would like to see a greater focus on well-being by their employer.[3] This includes an emphasis on physical, psychological and financial wellness. To help in this endeavor, the John Hancock Vitality PLUS program offers benefits similar to a corporate-wellness program — providing participating employees with rewards and discounts for exercise, nutrition, and other activities that promote a healthy lifestyle. For business owners looking for cost effective wellness strategies, a life insurance policy with Vitality PLUS has an annual cost of $24 per individual and is included in the premium.

Executive Bonus Plan

An Executive Bonus Plan is an arrangement in which the business pays the premium on a life insurance policy owned by the key employee as a "bonus" to the key employee. The bonus should be tax-deductible as a business expense.

How it works

Step 1

The business determines which valuable employee(s) to include in the plan, as well as the amount of bonus (or targeted death benefit) each key employee should receive. Each employee can be rewarded at a different level.

Step 2

The business enters into a separate agreement with each selected key employee, promising to pay the premium for the life insurance via a bonus, contingent upon the employee remaining with the business.

Step 3

The key employee will retain all rights of ownership in the life insurance policy, including the right to name the beneficiary and the right to access the policy cash value.

Income tax considerations

Single bonus approach

The premium the business pays is treated as a bonus and will be included in the taxable compensation of the key employee. This is referred to as a "single bonus" approach: the business bonuses the premium and the key employee pays the income tax due on the bonus out of his/her own pocket.

Double bonus approach

Another option is to increase the bonus amount to cover the key employee's increased tax liability. This is referred to as a "double bonus" approach: the business bonuses an amount to cover both the premium and the taxes so that the key employee has no out-of-pocket expenses.

You can select amongst your key employees, providing a double bonus for some and not for others, if desired. Either way, the total amount of the bonus made to each key employee is income tax-deductible to your business so long as it meets "reasonable compensation" guidelines.

Note: Regardless of the approach, the bonus made to each employee is income tax deductible to your business as long as it meets "reasonable compensation" guidelines.

Key benefits

For the business

- Motivates key employee to remain loyal to the business
- Ability to select which employees participate and customize benefits that add value to each employee
- Bonus amounts can be income tax-deductible
- Simple to implement and administer
- Your company may experience increased productivity and morale, and less absenteeism, as employees engage in the John Hancock Vitality program

For a key employee

- Insurance is owned by the employee and the employee names the policy beneficiary
- Potential source of tax-free supplemental income that can be used for future goals such as retirement
- Income-tax free death benefit
- Policy can be customized to provide lifetime benefits (through optional riders)
- With John Hancock Vitality PLUS the employee may earn rewards and discounts for living healthy

Considerations

- **An Executive Bonus Plan should be considered a long-term planning approach.** The minimum time horizon should be ten years, but shorter durations can be considered if growing cash value is of secondary importance.
- **Unlike deferred compensation plans, the business cannot recover the cost of the bonus from either the policy death benefit or cash value, as the employee is the sole owner of the life insurance policy.**
- **The key employee has an incentive to stay with the business to continue to receive the premium bonus.** However, he/she will not be required to repay any amount if he/she leaves the company. If a “golden handcuff” is desired, a REBA, which incorporates a vesting schedule, may be more attractive.

Restricted Endorsement Bonus Arrangement (REBA)

A REBA is a specialized form of an Executive Bonus Plan that includes "golden handcuff" provisions whereby the employee's rights in the policy, including access to cash value, is restricted for a period of time as set forth in an agreement.

How it works

A REBA is very similar to an Executive Bonus Plan with one additional step: a "restricted endorsement" on the policy is recorded with John Hancock. While the provisions of the restrictions can be negotiated, the standard restricted endorsement may prevent the key employee from:

Surrendering
the life insurance policy cash value

Withdrawing
cash from the life insurance policy cash value

Borrowing
against the life insurance policy cash value

Assigning
or pledging the life insurance policy as collateral

Changing
the ownership of the life insurance policy until retirement or a specified time

After the restriction period has expired, the endorsement is removed from the policy and the employee receives full rights over the policy, including access to the potential cash value.

In addition to this restriction, some employers may also impose a penalty if the key employee leaves the company prior to the end of the restriction period. This penalty is generally determined via a vesting schedule and requires the employee to repay the employer an amount equal to the "unvested" premium payments.

Income tax considerations

Taxation of a REBA (with a vesting schedule) can be addressed in one of two ways:

1. **Premium payments are excluded from the employee's taxable income until he/she becomes vested in such payment.** The ability to deduct the premium payment is also delayed per this same vesting schedule; or
2. **Similar to the Executive Bonus Plan,** each premium bonus is tax-deductible and the employee recognizes such amount into income.

Taxpayers should consult with counsel to determine the tax and legal consequences of the arrangement.

Employers often use a "double bonus" approach with REBAs, because the employee will have limited access to the policy cash value and may not be willing to pay taxes on money that is under restriction.

Key benefits

A REBA has many advantages in common with the Executive Bonus Plan, while also providing a stronger incentive for the key employee to remain with the business.

For the business

- Since a REBA is considered a long-term plan, it motivates employees to remain loyal to the business
- Ability to select which employees participate and customize benefits and vesting schedule that add value to each employee
- Receive a tax deduction on vested bonus amount
- Simple to implement and administer
- Recover costs if employee leaves before fully vesting
- Your company may experience increased productivity and morale, and less absenteeism, as employees engage in the John Hancock Vitality Program

For your key employee

- Insurance is owned by the employee and employee names the policy beneficiary
- Once vested, may provide a potential source of tax-free supplemental income that can be used for future goals such as retirement
- Income tax-free death benefit
- Policy can be customized to provide additional living benefits (through optional riders)
- With John Hancock Vitality, the employee may earn rewards and discounts for living healthy

Considerations

- **Like an Executive Bonus Plan,** a REBA should be considered a long-term planning approach. The minimum time horizon should be ten years, but shorter durations can be considered if growing cash value is of secondary importance.
- **As the employer,** you will need to discuss income tax deductions with your tax and/or legal counsel.
- **A REBA must comply with the provisions of Section 409A of the Internal Revenue Code and the applicable regulations.** A REBA is a non-elective deferral, and the employee pays taxes on the bonus as it vests, therefore complying with the provisions of Section 409A should not be difficult. Consult your legal, tax, and accounting advisors to make sure you are in compliance.

Use discretion when designing the vesting schedule

While the vesting schedule protects the business in case the key employee leaves earlier than expected, you want the key employee to view the plan as a valuable benefit. If the vesting schedule is perceived as onerous, the value of the plan may be diminished in the eyes of the key employee. This may become a point of negotiation.

Conclusion

An Executive Bonus or a REBA are great options to consider when you want to recruit, retain, and reward key employees. You can design a plan that is flexible, benefits your business, and creates a valuable benefit for your employees. An Executive Bonus Plan is simple to administer and execute, but for a plan that offers a "golden handcuff," a REBA might be the right fit. Work with your financial advisor to create a plan that suits you and your employees' needs.

For more information on these plans or to create a customized plan design,
please consult with your advisor.

1. Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions, such as when a life insurance policy has been transferred for valuable consideration.

2. Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts (MEC) may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% of the taxable income may apply to a MEC if the loan or withdrawal is taken prior to age 59½.

3. Source: What Employees Really Want at Work," Alan Kohll, Forbes, July 2018.

This material does not constitute tax, legal, investment or accounting advice and was not intended for — nor can be used by — a taxpayer for the purposes of avoiding any IRS penalty. Comments on taxation are based on John Hancock's understanding of current tax law, which is subject to change.

Some riders may have additional fees and expenses associated with them.

Insurance policies and/or associated riders and features may not be available in all states.

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Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02210 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.

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Not a Deposit	Not Insured by Any Government Agency	