Controlled Bonus Plan vs. Loan Regime Split Dollar Plan

The Controlled Bonus Plan introduces an executive benefit similar in some ways to loan regime split dollar without the impact of annual loan interest requirements. The executive's conditional liability in a Controlled Bonus Plan provides the employer with recovery of its bonus payments should the executive sever employment before a pre-arranged date.

Senior officers of publicly-owned corporations should be able to make use of the Controlled Bonus Plan whereas they are unable to use loan-regime split dollar due to the prohibition against loans to senior executives contained in the Sarbanes-Oxley legislation.

Very few advisers are aware of the uniqueness of the Controlled Bonus Plan, so be sure to introduce it to your business clients and their professional advisers before it catches on with your competitors.

Although the special definition of split dollar life insurance under Reg. Section 1.61-22(b)(2) appears to be broad enough to include bonus plans as split dollar, the employee, who is the nominal owner of the contract, would remain the owner. The special rule of Reg. Section 1.61-22(c)(ii) that would make the employer the owner when the only economic benefit being conferred is current life insurance protection would not apply because all policy rights are being conferred on the owner (the employee) by the non-owner (employer) and no rights in the death benefits or cash values are being retained by the non-owner. Reg. Section 1.61-22(b)(5) discusses non-owner payments that are not split-dollar loans or split dollar economic benefits. It says:

"If a non-owner of a life insurance contract makes premium payments (directly or indirectly) under a split-dollar life insurance arrangement, and the payments are neither split-dollar loans nor consideration for economic benefits described in paragraph (d) of this section, then neither the rules of paragraphs (d) through (g) of this section [economic benefit regime split dollar] nor the rules in §1.7872-15 [loan regime split dollar] apply to such payments. Instead, general income tax, employment tax, self-employment tax, and gift tax principles apply to the premium payments." [Material in brackets added for clarity.]

The general tax principles that would apply to this type of bonus payment would be the tax rules of Code Section 162 (for the employer's deduction) and the general income rules of Section 61 (for the employee's income).

Note: Care should be taken to avoid any bonus arrangement that could be construed to be a deferred compensation plan under IRC §409A. A deferred compensation plan can occur when the employer makes a binding promise to pay a bonus in the future. The bonuses contained in the Controlled Bonus Plan are structured as a series of discretionary annual bonuses payable in current years. Version 21.0[1] of InsMark's Documents On A Disk™ has specimen implementation documents for this plan that have been drafted in an attempt to avoid making the plan a deferred compensation plan under §409A. Each client's counsel must make certain to be completely satisfied in this regard.

[1] Version 21.0 of InsMark's Documents On A Disk™ is scheduled to be released in September 2013. Prior to that, any licensee for Version 20.0 can request copies of the implementation documents by emailing marketing@insmark.com and asking for copies of the specimen documents for the Controlled Bonus Plan.

Also part of the document set, the separate Employment Agreement is designed to be a stand-alone document that refers to the possibility of a life insurance bonus arrangement but does not specifically incorporate the bonus plan by reference, thereby making it clear that, although repayment for premiums bonused may be required, the two Agreements are separate. Section 7 of the separate Employment Agreement addresses the possibility of repayment of cumulative premiums paid. It contains two options: Option 1 requires full repayment of the cumulative premiums paid if the executive does not remain employed with the employer for the full, specified period; Option 2 has a declining schedule of repayment percentages based upon the number of years employed.

Important Note: The information in this report is for educational purposes only. In all cases, the approval of a client’s legal and tax advisers must be secured regarding the implementation or modification of any planning technique as well as the applicability and consequences of new cases, rulings, or legislation upon existing or impending plans.

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