

162 BONUS PLANS with REBA (Restricted Employee Bonus Arrangement)

For more details, see recent articles from publications and journals below:

Transamerica, "Restricted Executive Bonus Arrangement: REBA" Brochure , OLA 1012 T 1008

Christensen, "Several Methods Have Been Devised Which Allow Companies to Provide Life Insurance Benefits as an Executive Perquisite", 127 Trusts & Estates 83 (Feb. 1988);

Leimberg and Doyle, "Life Insurance Bonus Makes Good Dollars and Sense," Life Insurance Ideas 1, April 1991; Tools and Techniques of Life Insurance Planning;

Kraus, "The Private Pension Plan Revisited", 4 Pers. Fin. Plan. 41 (Sept/Oct 1992);

Kaltenbach, "Life Insurance Still Makes a Good Pension," Best's Rev. 64 (Jan. 1995);

Clolery, "Dangers of Insurance as a Private Pension Plan," Prac. Acct. 9 (Sept. 1994);

R. Landsberg, "Executive Bonus – Parts 1 and 2: Restrictive Bonus Arrangements" The Journal of Financial Service Professionals, March 2005, Vol. 59, No. 2.

162 Bonus REBA Plan Basics (from a legal and tax perspective)

1. Employer selects one or more employees to bonus on a film or TV production
2. Employer pays premiums on universal life insurance policies that retain cash values
3. Employee reports premiums that were paid into Employee owned policies as "bonus" income
4. Employer pays premiums to insurance carrier directly, or to Employee who pays all premiums
5. All policies are owned by each Employee outright --or by a 3rd Party (but not recommended)

Tax Implications if a 3rd Party purchases --and owns-- the life insurance policy:

- a. Income to Employee (is reportable on IRS Form W-2); Reg. Sec. 1.162-9; Rev. Rul. 58-90, 1958-1 CB 88; Brown Agency, Inc. v. Comm'r, 21 BTA 1111 (1931), acq. 1931 CB 10; Reg. 1.264-1(b).
- b. Bonus becomes a gift to the 3rd Party (under the Economic Benefit Doctrine and is still a valuable consideration as a Fringe Benefit under IRC 81 and IRC 61(a)(1)
- c. Federal Employment Taxes are excludible when gifts are made to a 3rd Party
- d. Employer still takes current Deduction (IRC Sec. 264(a)). Rev. Rul. 55-714, 1955-2 CB 51; Goedel v. Comm'r, 39 BTA 1 (1939) **to the extent it is reasonable.**
- e. Gifts to 3rd Party should still do a withholding in case they are subject to FICA/FUTA
- f. Employee's basis is the sum of all premiums paid into the life insurance policy
- g. 3rd Party owner retains all rights to cash values, beneficiary designations, ownership
- h. Employer retains no rights to policies. Employee retains no rights to policies
- i. Employer deducts premium as a bonus under Sec. 162 of the IRS tax code
- j. Employee reports bonus as income earned (even though no money is available)
- k. Withdrawals or loans made by Employee are subject to income tax as if Employee had purchased policy themselves

6. Employer can also pay life insurance costs directly to the carrier and it's still a bonus of salary
7. Employee can increase the death benefit if they so choose by paying additional life premiums
8. Proceeds in the event of death are income tax free to the beneficiaries. Whoever is the owner of the policy can name the initial beneficiary, and can change the beneficiaries at any time
9. Cash values grow tax free (and can be borrowed tax free --up to basis) by the policyowners

162 SETTING UP THE PLAN (from a documentation and employee agreement standpoint)

10. REBA (Restricted Employee Bonus Arrangement) also (...Endorsement Bonus Agreement)

- i. Corporate Resolution
- ii. Employment Agreement with Employee
- iii. Restrictive Endorsement
- iv. Employer retains the right to terminate the control of the cash values (but does not control the right change the beneficiary in the event of an Employee's death)
- v. Resolution and Agreement list face amount (death benefit), terms, conditions and eligibility –if any.

11. Department of Labor (ERISA rules and issues if the Employer pays premiums to carrier)

- vi. None if the plan covers only owner-employees or those who are highly compensated
- vii. Minimal reporting, disclosure and claims procedure. If common law, Employees who are covered must have a plan in writing (e.g., a Corporate Resolution adopting a plan must be sufficient, and have at a very minimum, a Summary Plan Description (SPD)). Moreover, plan documents must be furnished to participants on request. Employer must name itself or another entity as the plan fiduciary and specify duties. The plan documents must specify how the plan is to be financed. It must contain provisions for amendment, and specify terms of payment and claims procedure. See DOL Reg. Sec. 2520.104-24(a)-2520.104(c)

12. Downsides to the plan

- a. Employer has no access to the cash values, only a bank or law firm as a fiduciary
- b. Employee can't recover outlays or cash values until vesting or endorsement terminates
- c. Employee has all ownership and control of the policy proceeds for death beneficiaries

13. Restrictive Endorsement Bonus Agreements

- a. No Employee rights of policy cash value withdrawal without fiduciary's consent
- b. Restrictive Endorsements Bonus is often temporary (for a number of years --say 10)
- c. Policy endorsements and restrictions are executed by an Employee and filed with a life insurance carrier. Temporarily restricts some of Employee's rights (e.g. the surrender of the policy, taking policy loans, pledging the policy's values) without the Employer's specific written permission and release.
- d. Employee retains the unilateral right to name (or change a Beneficiary) in the future
- e. Expires at specified future date (e.g. attained age, retirement date, date Employee is fully vested in Employer's stock rights, etc.). May also expire on Employer's potential bankruptcy or dissolution of the Employer's company prior to otherwise stated date.
- f. Employment Agreement not tied to life insurance nor does Employer get any rights to policy's cash values or death benefit from the Employment agreement (only the REBA)
- g. Employment Agreement should address vesting, changes in control, insolvency, etc.

14. ERISA Issues in 162 Bonus REBA with life insurance: (Welfare Benefit Plan: Sec. 3(4)).

- If it is a "top hat" plan (select group of management or highly compensated Employees):
- i. Employer must provide copies of the plan to Sec. Of Labor upon request
 - ii. Exempt from other ERISA reporting and disclosure

- iii. Subject to Part 4 of Title 1: Must have written plan document and must appoint a "named fiduciary".
- iv. Corporate Resolution should serve as written instrument.
- v. Officer of the Employer can be named fiduciary
- vi. Sec. 503:
 - a. Must have claims procedure which provides plain language written notice to Employees and/or beneficiaries if claims denied.
 - b. Must give beneficiary reasonable opportunity for full and fair review.

15. The IRS and SEC do not require all employee bonuses to be disclosed

Generally speaking, the Internal Revenue Service and Securities and Exchange Commission (SEC) only requires publicly traded firms to disclose to their shareholders the compensation given to the CEO, CFO and the top three highest-paid employees. Employee bonus plans benefit from this disclosure rule.

ERISA Implications – Title 1 of ERISA covers all employee benefit plans and divides them into welfare plans and pension plans. To be covered by ERISA, there must be a “plan.” If a REBA is a negotiated arrangement between an employer and a single employee, there is a strong argument that there is no “plan” and ERISA does not govern the arrangement. However, if there are multiple employees covered by REBAs, it is more likely that there is a “plan” for ERISA purposes. In the event a REBA is considered a “plan,” it may qualify as a “top hat” plan if it only covers select management or “highly compensated” employees. ERISA reporting requirements for “top hat” plans are limited. Whether a REBA is subject to ERISA must be determined on a case-by-case basis.

Section 409A – Section 409A of the Internal Revenue Code imposes extensive substantive requirements on arrangements that purport to accomplish a deferral of income or the taxation of income. By its own provisions, failure to satisfy these requirements will result in the loss of deferral of recognition and taxation of the income.

Section 101 – Section 101 of the Internal Revenue Code imposes income tax on the death benefit of life insurance contracts owned by the employer of the life insured unless certain exceptions apply. All such exceptions include satisfaction of notice and consent requirements set forth in the section.

IRS Code Citations – See Treas. Reg. §1.61.2(d)(2)(ii)(a) (“Generally, life insurance premiums paid by an employer on the life of his employee where the proceeds of such insurance are payable to the beneficiary of such employee are part of the gross income of the employee.”)

IRC §264(a) provides that the employer is not entitled to a deduction when the employer is directly or indirectly a beneficiary under the policy. Some planners believe that

§264(a) can prevent the deduction of premium payments when the employee forfeits the policy upon early termination. The application of §264(a) should be avoided by immediate vesting.

Top Hat Plans must be in writing and set forth claims procedures and the identity of the plan fiduciary. A statement must be filed with the Department of Labor within 120 days of the adoption of a pension plan that meets the top hat requirements. Plan documents must be made available upon request.