Executive's Plan Costs of the Leveraged Executive Bonus (Blog #204)

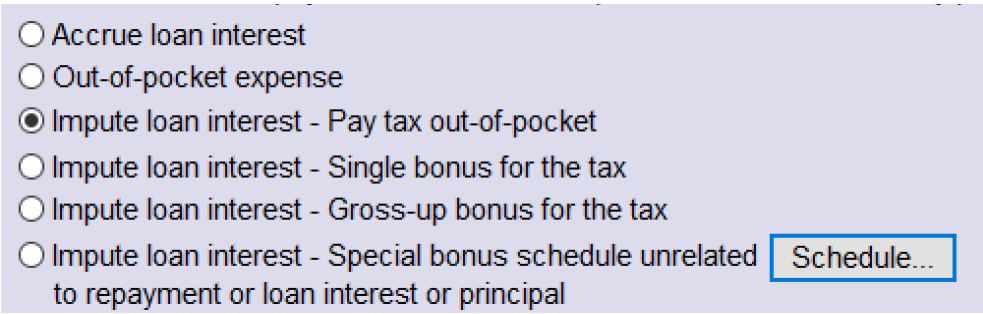
Let's examine the structure of this plan as it affects the four initial premiums which are funded using an executive bonus coupled with loan regime split dollar.

Year	(1) Tony's Policy Premium	(2) Company's Bonus to Tony	(3) Tony's Tax on the Bonus[1]	(4) Split-Dollar Loan from Company to Tony	(5) Tony's Out-of-Pocket Premium Cost (3) - (4)
1	250,000	250,000	80,000	80,000	0
2	250,000	250,000	80,000	80,000	0
3	250,000	250,000	80,000	80,000	0
4	250,000	250,000	80,000	80,000	0

[1] 32.00% marginal income tax bracket

Tony may have some out-of-pocket costs based on the selection of loan interest payments.

Loan Interest Payment Options



- **Accrue loan interest**
  This selection is tempting because it eliminates all costs for Tony. However, it increases the cumulative split-dollar loan, which, in turn, requires more invasive access for a policy loan to repay Town and Country's premium loans. This result, of course, reduces cash values that are the source of Tony's after-tax retirement cash flow.

  That said, "accrue loan interest" probably results in the most straightforward plan administration, but its most significant negative is its effect on Tony's retirement cash flow.

- **Out-of-pocket expense**
  This selection produces the highest cost for Tony.
  Example for year 1:

  $80,000 split-dollar loan x 1.12% AFR = $896.

- **Impute loan interest - Pay tax out-of-pocket**
  This is a tempting option, and I usually select it. Tony ends up paying tax on the $896 noted above.

  $80,000 split-dollar loan x 1.12% = $896 of imputed income;

  $896 x 32.00% (Tony's tax bracket) = $287.

  Click here to show the overall results for Tony.

- **Impute loan interest - Single bonus for the tax**
  Example for year 1:

  $80,000 premium x 1.12% = $896 of imputed income;

  $896 x 32.00% (Tony's tax bracket) = $287;

  $287 x 32.00% (Tony's tax bracket) = $92.

- **Impute loan interest - Gross-up bonus for tax**
  Example for year 1:

  $80,000 premium x 1.12% = $896 of imputed income;

  $896 x 32.00% (Tony's tax bracket) = $287;

  $422 gross-up bonus provides Tony with $287;
  $287 - $287 = $0.00 out-of-pocket for Tony.

With loan regime split-dollar, there is a practical reason to impute loan interest. Historically, it has been common practice to illustrate bonuses to assist in the payment of loan interest or loan repayment. This strategy conflicts with this often overlooked prohibition:

If bonuses help pay loan interest or repayment of the employer's loans, do not have the employer directly or indirectly make these payments on behalf of the executive. The purpose of this is to comply with the prohibition against the employer making such payments as provided in the split-dollar final regulations issued in 2003 (TD 9092, 9/11/03 and Rev. Rul. 2003-105).

If, however, imputed loan interest is selected, using a bonus to offset the income tax on the imputation is a suitable option. Leveraged Executive Bonus is usually more efficient for all parties than either an executive bonus plan or loan regime split-dollar plan used separately.

Imputed loan interest is often misunderstood by some commentators. Click here for an analysis by Michael Tuchman, Esq., Partner - Levenfeld Pearlstein, LLC, Chicago, Ill.