



ROP Term & Executive Bonus

Do you have a business owner that would like to provide a “golden handcuff” type fringe benefit for one or two key employees but isn’t quite ready for a nonqualified deferred compensation plan? Do you have a business owner that wants a selective benefit because the employer either doesn’t want or can’t afford to provide similar benefits for all employees? Does your business owner prospect want the fringe benefit to be tax deductible? If so, consider using the executive bonus arrangement using Return of Premium (ROP) term.

Facts: Arnie Palmerton owns two golf equipment stores. “Arnie’s Bunker” stores are well known to the area golfers and have a good reputation for quality and value. Both stores are located in states where lakes freeze in the winter – making the business quite seasonal. Competition from “Galactic Golf Megastores” is squeezing Arnie’s profit margins. Both stores have a core group of full-time employees and a number of seasonal employees. Arnie’s golf course design business takes him all over the country, so he depends on his two key employees – Tiger and Phil – to run the day-to-day operations. Tiger and Phil have approached Arnie with concerns about protection for their families, should lightning strike them on the golf course. They are also worried about retirement savings but realize that business is tight and there are limits to Arnie’s generosity.

Arnie wants to do something for Tiger and Phil but dislikes administrative burdens. Arnie is willing to pay “something” to reward Tiger and Phil for their loyalty and to help protect their families, but he also wants that “something” to be tax deductible.

Solution: Pru’s “Return of Premium” (ROP) term, used with an executive bonus arrangement, may be just the solution. Tiger and Phil apply for and own the face amount of ROP term that meets their needs. The employer-paid premium will be deductible to Arnie’s Bunker (subject to reasonable compensation) and taxable as ordinary income to Tiger and Phil. During the level-term period valuable life insurance protection is provided. At the end of the level-term period, Tiger and Phil will receive the return of their premiums paid, subject to conditions outlined later in this material – a real “win-win” solution!

The executive bonus arrangement is simple to implement and administer. The employee buys and owns a life insurance policy, naming someone other than the business as the beneficiary. The business agrees to pay the premiums directly

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to the insurance company or to pay a cash bonus to the employee so the employee can pay the premiums. The company is free to select who will receive benefits and is not bound by the complex requirements that govern qualified plans. The premium payment is taxable as income to the employee and tax deductible to the business as long as the executive’s total compensation is considered reasonable.

Benefits of this arrangement include:

For the Employer:

- The employer can pick and choose the employees that will be allowed to participate.
- Bonus levels can vary from employee to employee.
- The bonus is tax deductible if compensation is reasonable.
- The arrangement can be terminated at any time.
- No IRS approval is needed.
- It is easy to implement and has minimal administration.
- It can provide an incentive for participating employees to stay with the company since future bonuses are contingent on the employees continuing to work for the firm.

For the Employee:

- The executive is able to obtain life insurance protection at a lower out-of-pocket cost than if purchased by the executive. Out-of-pocket costs could be completely eliminated if the employer provides a “double bonus” (enough to pay the premium plus the income tax due on the bonus).
- The policy is portable and can provide life insurance coverage before and possibly after retirement.
- The ROP amount returned at the end of the level-term premium period represents a tax-free return of premiums paid, and this lump sum can be used to supplement other benefits. Premiums paid under the waiver of premium are not returned. Any outstanding loans, inclusive of loan interest, will be subtracted from the amount returned to the client. Not all premiums may be returned if the policy is surrendered before the end of the level payment period. The insured must be alive at the end of the level premium period to receive the return of premiums.
- At the executive’s death, cash is available to replace the executive’s income to his/her family, to help liquidate debts, and/or to pay estate taxes and administration costs.

CHART OF CONCEPT ATTACHED

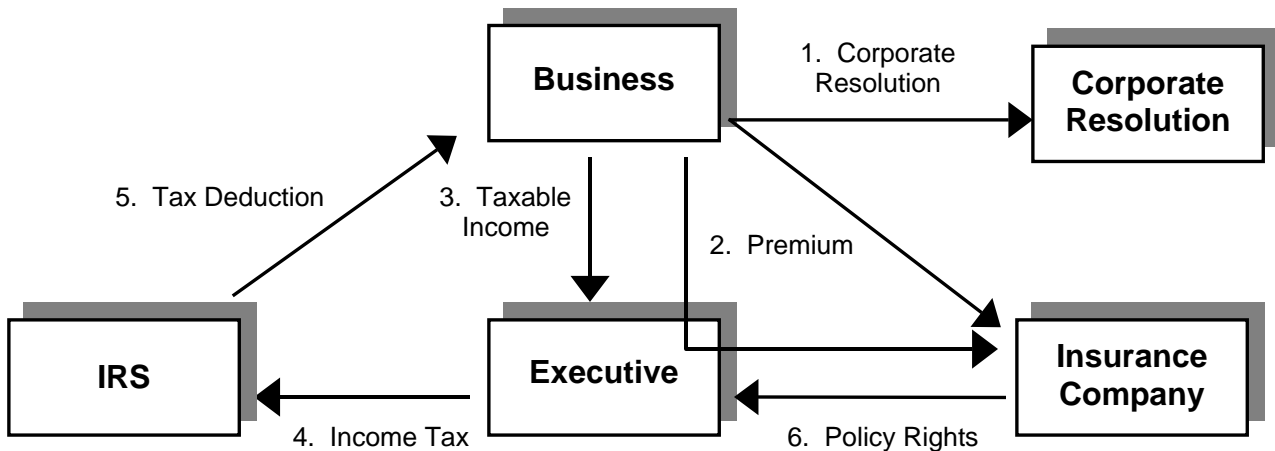
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The Structure of an Executive Bonus Arrangement



1. The business notifies the participants of its intention to establish an executive bonus arrangement and, if applicable, adopts a corporate resolution.
2. The business pays a bonus to the executive who then pays premiums to the insurance company for a policy he/she generally owns. Alternatively, the business may decide to pay the premium directly to the insurance company.
3. The bonused amount is included in the executive's gross income for the current year.
4. The executive reports the bonused income and remits the appropriate tax.
5. The business receives a tax deduction in the year the bonus is included in the executive's income.
6. The executive has full policy ownership rights, including the right to any policy values, the right to name a personal beneficiary, and the right to name a third party, such as a trust, as policy owner.