Accounting guidelines for Bonus plans

With this bonus plan, the financial asset is owned by the key employee. As such, it's not an asset of the employer and doesn't appear on the employer's balance sheet. The bonus is generally treated as additional compensation in the employer's financial statements. In some situations, with owners of pass-through entities, the bonus is treated as a distribution with an accompanying reduction in basis. Employers should consult with their accountants and other tax advisors to determine the accounting treatment that will be used for financial reporting for their particular plan.

Journal transaction example:

1. In this hypothetical example, the employer provides compensation of $20,000 to the key employee and deducts the $20,000 compensation in the year paid.
2. Utilizing a double bonus plan design, the employer makes an additional $8,571 payment to the key employee to compensate the key employee for the taxes on the base compensation (plus the tax on the bonus) in a combined 30% marginal income tax bracket (federal and state). The employer also deducts the additional payment as compensation in the year paid.

This hypothetical example is for illustrative purposes only.

	Balance Sheet		Income Statement	
	Debit	**Credit**	**Debit**	**Credit**
1. Base compensation to key employee Bonus wage expense			$20,000	
Cash		$20,000		
2. Income tax cost of bonus to key employee* Bonus wage expense			$8,571	
Cash		$8,571		

* The employer could choose to help the key employee with the taxes on the bonus tax costs. Following is a sample calculation: $20,000 x 30% (example employee tax rate) = $6,000 of taxes. If the employer wants to “double bonus” the key employee an amount to cover the $6,000 plus the taxes on this bonus (gross it up for taxes), the calculation is $6,000 / (1 – key employee tax rate) or $6,000 / (1 – 30%) = $8,571.

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