



Frequently Asked Questions on 412(i) Plans

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Basics

What is an IRC Section 412(i) Plan?

An IRC §412(i) Plan is a defined benefit plan that provides for retirement income that is guaranteed with an insurance company's life insurance and/or annuity contracts. It is sometimes called a "Fully Insured Defined Benefit Plan."

Who may sponsor a §412(i) plan?

Any established business entity such as Corporations, Sole Proprietors, or Partnerships seeking to maximize tax deductions and provide a substantial retirement benefit for owners and other long-term quality employees.

Could all employers benefit from a §412(i) plan?

No. The 412(i) plan is most advantageous for small stable business owners who are age 45 and over with 15 or fewer employees.

If a sponsor has another plan in place can he/she still adopt a §412(i) plan?

Usually Yes. How this is achieved will depend on the current plan type. Talk to us about current plan specifics.

How does a §412(i) Plan work?

The Trustee(s) purchase Annuity and/or life insurance contracts with underlying guaranteed returns. These contracts will provide the retirement benefits promised in the plan. Guaranteed contracts remove all the investment risk for the employee and employer because minimum returns are guaranteed and contributions are known. Benefits are funded over the working lifetime of each employee. The deductible contribution goes to fund these contracts each year. At retirement, the monies accumulated can be rolled over to one's IRA account without taxation (until withdrawn from the IRA), taken in cash (a taxable event), or taken as a monthly income for life (taxed as ordinary income as received).

Are these plans safe?

Yes. Introduced with ERISA (Employee Retirement Income Security Act) in 1974, §412(i) Plans are a well-established part of the pension plan code. §412(i) provides an additional layer of safety from investment risk for both the employee and the employer. Contributions are invested in either life insurance contracts and/or annuities providing guaranteed interest rate returns and security. §412(i) Plan documents are reviewed by the Internal Revenue Service and receive a prototype determination letter ensuring the plan is properly set-up.

Does the IRS approve of these plans?

Yes. 412(i) Plans, Inc. will file the plan, along with all other required documents, with the Internal Revenue Service. A favorable determination letter is issued directly to the plan sponsor by the Internal Revenue Service.

Is an enrolled actuary required?

No. However, 412(i) Plans, Inc. employs an enrolled actuary to ensure all plans are designed and administered within the spirit of the law.

Requirements

What requirements must a plan meet to qualify under §412(i)?

Plans must be funded exclusively with guaranteed products. These can be annuity contracts or a combination of insurance and annuity contracts. The contracts must provide for level annual premium payments until retirement of employees and must provide the benefit and be guaranteed by the insurance carrier to the extent premiums are paid. The plan may not make participant loans nor may plan assets be pledged in any way.

What investments are allowed in §412(i) Plans?

Section 412(i) of the Internal Revenue Code requires plan assets to be invested solely in annuity and/or life insurance products.

Why is it desirable to qualify under §412(i) of the IRC?

Compliance with the law is crucial to the qualification of a 412(i) plan. Plans qualifying under §412(i) are exempt from the funding limitations of IRC Section 412. These plans can provide deductions often three times greater than traditional defined benefit plans and maybe as much as six times or more than defined contribution plans. They provide employers with the ability to “fast fund” a retirement plan for an older employee without increasing costs for younger employees.

Do the Affiliated and Control Group Rules of §414 apply?

Yes. It is very important that we be made aware of any and all companies that the employer has an interest in, no matter how obscure. These details have particular importance to the ongoing qualification of the plan.

Costs

Who bears the cost of a §412(i) Plan?

The sponsoring business entity covers the set-up and annual administration fees and makes the contributions to the plan.

The check for the plan contribution is made payable to whom?

The Insurance Company for all plan contributions and 412(i) Plans, Inc. for the administration fees.

Is there any cost to the employees?

If the plan is funded with life insurance in addition to annuity contracts, the participants recognize the cost of the “current economic benefit” provided by the life insurance. This cost is commonly referred to as a PS-58 cost. In all cases, the specific “current economic benefit” for each employee will be provided each year to the employer for distribution.

Tax Benefits

Are the contributions tax-deductible?

Yes. The employer’s contributions are tax-deductible for the sponsoring employer and the contribution for employees’ benefits are tax-deferred to the employee.

Are administration fees tax-deductible?

Administration fees are deductible expenses. In addition, the IRS allows a tax credit of 50% of the start-up costs (not to exceed \$500).

Is there a tax on the asset growth in the plan?

No. All accumulations grow tax-free.

Funding

What is the maximum a “typical client” can put away?

This varies based on the client’s age and Normal Retirement Date (NRD). However, due to the funding assumptions mentioned earlier, contributions may be up to three times more than the contributions to a traditional defined benefit plan and six times more than in a defined contribution plan.

Can I design a plan to target at a certain contribution level?

Yes. Contributions can be made at whatever rate you are comfortable with, within the funding guidelines prescribed by law. This is an important aspect of the initial illustration. Be sure to mention this goal when discussing the plan design and objectives.

If there is a “bad year” in the business, can one skip a year of funding?

No. However the plan can be amended in future years to reduce funding levels.

How are the contributions for a §412(i) Plan determined?

Using the guaranteed purchase rate of the annuity, we know how much is needed to provide the promised benefit at retirement (target). The number of years to normal retirement (NRA) is figured and working backwards with the guaranteed interest rates; the annual level premium needed to reach the target at retirement is calculated.

What is the advantage of using contract guarantees to determine the funding?

Typically, the contract guarantees are much lower than the interest rate used to calculate funding for a traditional defined benefit plan and this results in higher contributions and higher deductions under a §412(i) plan. Typically, annuity and whole life contracts have a 3% guarantee. A traditional defined benefit plan typically uses 6.0% pre-retirement and 5.0% post-retirement to calculate contributions.

Distributable Benefits

At retirement, what happens to the insurance in the plan?

The participant may elect to continue the permanent life insurance benefit after retirement by buying it for its cash value, or the policy can be surrendered by the plan for its cash value. Another option is to have the policy distributed directly to the client as part of his benefit. The cash surrender value of the policy will be taxable to the recipient in the year the policy is distributed.

What happens if someone dies while an active plan participant?

This is an important reason why the plan has life insurance benefits. The beneficiary receives the difference between the policy's cash value and the total death benefit income tax free. The portion of the death benefit equal to the cash value minus the PS-58 costs paid for the "current economic benefit" is taxed as ordinary income. The annuity is distributed to the beneficiary or surrendered for cash and the cash is distributed to the beneficiary. Taxes are generally due at the time of distribution unless a spouse elects the "spousal IRA rollover".

Installation

What are the fees for a §412(i) Plan?

Design and Installation Fee (one-time): \$2,500
Annual Fee: \$2,000 plus \$100/per participant

Additional fees will be charged to terminate, take over the administration of an existing plan or freeze existing plans.

How do I get a §412(i) Plan Illustration or more information?

Go to our web site: www.412iplansinc.net, or call us at 888.412.4120