

Life Insurance in Qualified Plans

Presentation by
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Defined Benefit Pension Plans

What's Old is New Again
&
Better Than Ever

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The New Economic Realities for Business Owners, Employees, Beneficiaries, and Financial Service Providers

Overview

- Reality check ahead
- Playing by the rules
- Putting all the pieces together



The reality for business owners/plan sponsors

- Steep asset declines
- Heightened potential for fiduciary liability
- Tough decisions on plan funding
- Deadline for new compliance requirements



The reality for employees


- Those that have jobs
- Those that don't



The challenge for us

- Law firms
- Accounting firms
- Advisors
- Service providers

“Trust is an economic stimulus package.”



The focus of advanced planning using life insurance

1. Making premium deductible
2. Protecting the business
3. Part of the estate planning strategy



Trying to get there in other ways

- Section 79
- Retired Lives Reserve (RLR)
- Reverse split dollar
- Section 419
- 412(i) springing cash values



1A. Making premiums deductible: “incidental death benefits”

Defined benefit plans

- 100 Times Pension Amount
\$2000/mo. Pension X 100 = \$200,000 Face Amount
- Rev. Ruling 74-307



1B. Making premiums deductible: “incidental death benefits”

Defined Contribution Plans

- Whole Life: cumulative premiums less than 50% of cumulative contribution
- Variable Universal & Term: cumulative premiums no more than 25% of cumulative contribution



Exceptions to incidental death benefit rules

- 100% of rollover assets can be used to purchase life insurance
- Only for profit sharing plans
 - 100% of account if participated for 5 years
 - 100% of assets in plan for 2 Years



2. Protecting the business

- More life insurance flexibility in profit sharing plans
- Funding a buy-sell agreement



PLR 8108110

- Is life insurance policy on B's life and allocated to the profit sharing account of A permitted? **"See the DOL."**
- Will payment of premiums from A's account be taxable income to A: **"Yes."**
- Will proposed transaction effect qualification of plan and tax-except status of trust? **"See Key District Director."**

Practical issues must be resolved



3. Part of the estate planning strategy

What about the subtrust strategy?



How the subtrust is usually implemented:

- Plan amended to create subtrust to receive proceeds of insurance
- Subtrust names a “special trustee” to hold all incidents of ownership
- Subtrust to act as irrevocable life insurance trust, the beneficiaries of the subtrust usually participant’s children



Does the subtrust work?

- Unpublished 2007 TAM: “The subtrust considered in the memorandum caused the pension plan to be disqualified ...” August 2008 Leimberg’s *Think About It*.

- Other practical issues

Putting All The Pieces Together





Two types of clients

- Those who want to put more money away for retirement
- Those who need an exit strategy



How recent tax legislation encourages DB plans for business owners

- DB limit has COLA adjustment: \$185,000/yr beginning at age 62 (2008)
- DB and DC benefit limits uncoupled (Section 415)
- 401(k) doesn't count against 25% deduction limit (Section 404)
- 25% combined plan deduction limit removed
 - Extra 6% of pay for DC if not subject to PBGC
 - 25% to DC + cost to fund DB if subject to PBGC



Here's an example:

Net Earnings Before Qualified Plan Deduction	\$220,000.00
Calculate 1402(a)(12) Deduction	\$203,170.00
Calculate Medicare and FICA	\$18,539.93
1/2 of Self-Employment Tax	\$9,269.97
Self-Employment Income	\$210,730.04



And here's the maximum contribution to one plan:

Maximum Profit Sharing Contribution	\$42,146.01
Maximum 401(k) Contribution	\$15,500.00
Maximum 401(k) Catchup	\$5,000.00
Maximum Contribution	\$62,646.01
Annual DC Limit Under Section 415	\$51,000.00
Maximum SIMPLE	\$16,637.77
Maximum SIMPLE Catch-Up	\$2,500.00
Total Maximum SIMPLE	\$19,137.77
Maximum SEP	\$42,146.01
Maximum DB	\$154,274.34



And here's the maximum contribution to both DB and DC using new rules

Maximum DB	\$154,274.34
Maximum 401(k)	\$15,500
401(k) Catch-Up	\$5,000
New 6% DC Rule	\$12,643.80
Total Both Plans	\$187,418.14



Adding a cash balance to existing PS/401(k)

	2007 PS/401(k)		2008 Combined Plans				Increase	
	Allocation	%	PS/401(k)	Cash Balance	Total	%	\$	%
Owners								
1	\$45,000.00		\$46,000.00	\$75,000.00	\$121,000.00		\$76,000.00	
2	\$50,000.00		\$51,000.00	\$125,000.00	\$176,000.00		\$126,000.00	
	\$95,000.00	61.59%	\$97,000.00	\$200,000.00	\$297,000.00	72.44%	\$202,000.00	78.98%
Non-Owners								
35	\$59,250.00	38.41%	\$78,000.00	\$35,000.00	\$113,000.00	27.56%	\$53,750.00	21.02%
Total	\$154,250.00	100.00%	\$175,000.00	\$235,000.00	\$410,000.00	100.00%	\$255,750.00	100.00%



Exit Strategies

- Many strategies
 - Several variations to each strategy
- Match strategy to client's goals



Exit Strategies

- Roll to new plan
- Surrender
- Annuitize
- Distribute
- Purchase original policy
- Purchase new policy

Going forward

- Tax rules the best ever
- New economic realities
- Better planning

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And our attorney wants me to remind you again that:

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