

NATIONAL BENEFIT SERVICES, INC.
BENEFIT BRIEFING
June, 2009

**LIFE INSURANCE IN PROFIT SHARING PLANS:
How Business Owners Can Use Their Profit Sharing Plans
as a Premium Source for Life Insurance**

Introduction

Most business owners understand the need for life insurance but in today's economy sometimes have a problem finding the cash to pay for it. A little known tax planning technique is to use a profit sharing plan as a premium source to buy needed life insurance.

This *Benefit Briefing* will provide answers to frequently asked questions (FAQs) to help you understand how this can be accomplished.

Why even consider the use of a profit sharing plan to buy life insurance?

The answer is simply that you can pay the premiums with tax-deductible dollars and thus reduce your out-of-pocket cost.

What are the limits on life insurance in a profit sharing plan?

The amount of life insurance that can be purchased in a qualified retirement plan are subject to what the Internal Revenue Services calls the "Incidental Death Benefit Rule".

That Rule limits:

- Whole life insurance premiums to no more than 49.99% of the contributions
- Term insurance and variable universal premiums to no more than 24.99% of premiums

Are there any exceptions to these Incidental Death Benefit rules?

Yes. There are three important exceptions that allow other money to be used to purchase premium:

1. 100% of the account can be used if the participant was in the plan for at least 5 years.
2. 100% of the assets in the plan can be used if the assets were in the plan for at least 3 years.
3. 100% of rollover assets can be used.

What exactly are rollover assets?

Recent tax law changes made it easier to rollover accounts from prior employer plans and Individual Retirement Accounts. There is no limit on the amount of these funds that can be used to pay for life insurance premiums.

Can only the participant be insured?

There is more life insurance flexibility with life insurance in a profit sharing plan than with a defined benefit plan.

Generally, the only person who can be insured in a defined benefit plan is the plan participant. However, in a profit sharing plan the insured can be a spouse, business partner, parents, or children.

In addition, survivorship policies can be used, the use of which can accomplish a number of objectives.

What's the advantage of having life insurance as part of the retirement plan?

Using plan assets to purchase life insurance has the following advantages:

- The insurance provides more death benefits to cover any taxes.
- The excess of the death benefit over the cash value can be received income tax free.
- The cash value part of the death benefit can be rolled tax free to an IRA.

What are the tax consequences for the plan participant?

A portion of the life insurance is considered to be a current benefit. As such, a portion of the death benefit is considered current income.

How is the benefit taxed?

The tax is based on the "one year term cost". The IRS's Table 2001 is used to calculate the tax. However, the insurance company's one year term rates can be used if they are made available to all standard risks.

How much life insurance should be purchased?

While up to 50% of the contribution can be used to purchase whole life insurance, it may not be a good idea to do so. Employer contributions to a profit sharing plan are discretionary. If the employer has a bad year, there may not be enough contributions to pay the premiums.

What happens to the life insurance if the plan terminates or when the participant is no longer covered by the plan?

There are several exit strategies that can be used to accomplish personal objectives. The life insurance policy can be:

- Surrendered
- Annuitized
- Distributed
- Purchased

Can any participant in a profit sharing plan use his account to buy life insurance?

No, the plan document must specifically have the appropriate provisions to permit this. Our own plan documents which are pre-approved by the Internal Revenue Service allow a plan sponsor to permit life insurance to be purchased by any participant in the plan.

About National Benefit Services, Inc.

Founded in 1978, National Benefit Services, Inc. provides retirement plan consulting and administrative services for a wide range of privately held and publicly traded employers.

For further information contact:

Jerry Kalish, President
National Benefit Services, Inc.
300 West Adams, Suite 326
Chicago, IL 60606
Phone: 312-419-9080
Fax: 312-419-9099
Email: jerry@nationalbenefit.com
Subscribe to our blog:
www.retirementplanblog.com

* * *

This Briefing is published for information purposes only and should not be considered tax or legal advice.