Qualified Retirement Plans
Under IRC 412(i)

Introduction
One typically has several major objectives in tax planning, all of which one would ideally like to accomplish. These objectives include:

1) Significantly reduce income taxes;
2) Enjoy asset protection;
3) Avoid investment risk;
4) Avoid tax risk; and
5) Integrate the strategy with other life and estate issues

With most strategies, there are substantial tradeoffs with regard to their advantages. One strategy may offer attractive tax savings but with high tax risk. Another may have low tax risk but be at the expense of high investment risk or low liquidity levels. Yet another may offer low investment risk and low tax risk but requires the taxpayer to give a substantial portion of the assets away to charity or to employees.

Fortunately, one strategy allows all the major objectives listed above. This is a 412(i) qualified retirement plan. This strategy allows one to enjoy the following benefits:

- **Pre-Approved by Internal Revenue**
- **Large tax deductible contributions**
- **Tax Deferred Growth of Invested Assets**
- **Guaranteed investment returns**
- **Large tax-free death benefits**
- **Asset Protection**

The following supports this strategy:

- **Determination Letter from the IRS**
- **Underwritten by AA rated carrier**
- **Guarantee of plan acceptance by the IRS**

What Is A 412(i) Plan?
A 412(i) Plan is a retirement plan which allows clients to generate large tax deductible contributions, enjoy steady, tax-free earnings, while minimizing the amount of contributions that must be allocated to the employees.

Under the Internal Revenue Code, a Section 412(i) Plan is a defined benefit retirement program that is, as required by law, funded with life insurance and annuity contracts. Section 412(i) allows current contributions to be calculated using the guaranteed cash values and annuity purchase rates of life insurance products. ***This allows a taxpayer to fund contributions on a tax***

deductible basis in amounts greater than are typically allowed for other qualified plans.

In addition, under regulations promulgated under Section 401(a)(4), "cross testing" of benefits among plan participants allows taxpayers to effectively skew the benefits in the client's favor, as the requirements allow the benefits, rather than the amounts contributed to the plan, to be the relevant benchmark in ensuring that discrimination rules are not violated.

Comparison to Other Defined Benefit Plans
Most successful small businesses do not have a defined benefit plan. This is due to several factors. First, traditional defined benefit plans cannot fund enough for the owner to warrant the perceived complexities and costs. Second, traditional plans require high matching contribution levels for employees, thereby making the plan relatively more expensive for the owner. Because of the advantages applicable to our 412(i) Plans, we are able to structure a retirement plan which substantially increases the contributions that go to the owner, decrease the ongoing costs and complexities, and structure the plan to otherwise benefit the owner.

Following is a sample of the maximum deductions available for a 55 year old business owner under different qualified plans:

Table 1 – Comparison of Qualified Plans

Plan Type	Owner's Maximum Deduction
Profit Sharing	42,000
Money Purchase	42,000
Comparability	42,000
Traditional Defined Benefit Plan	145,201
412(i) Plan	**339,857**

How It Works
Because situations differ, each 412(i) Plan must be customized to meet your specific objectives. Following, however, are the major steps in establishing and implementing these strategies.

Structure

Determining the proper structure is the first crucial element to a successful 412(i) Plan. While one typically wants to maximize tax deductibility, a host of variables must be analyzed in order to ensure tax compliance while accommodating other goals. These variables include age and health status, company structure(s), income levels of proposed plan participants, number and roles of employees, existence of other qualified plans, post-retirement goals, current and future income needs, among other issues.

As with any other qualified plan, the 412(i) Plan must adhere to plan participation and anti-discrimination requirements. Therefore, in order to ensure that one can maximize the amount of contributions, several planning options may be employed. These may include such tactics as 1) imposing vesting requirements for employees; 2) establishing nonaffiliated entities from a pension plan perspective from which the plan is funded; 3) excluding employees based on the existence of other qualified plans; 4) and other techniques.

Funding and Administration

Once the proper structure is determined, a retirement plan is established and submitted to the IRS for approval on its tax deductible and tax exempt status. Meanwhile, plan contributions begin with the contributions going towards the funding of a combination of interest sensitive whole life insurance and annuity products.

Legal Status

As indicated above, this plan receives a Favorable Determination Letter from the IRS specifically granting it tax-exempt status.

Conclusion

A 412(i) Plan can be the ideal solution for owners of small and medium sizes businesses and professional practices. This strategy allows one to maximize tax deductions while minimizing the amounts contributed for employees. In addition, with the 412(i) Plan, one can minimize investment risk and tax risk without having to get into the usual convoluted tax shelter schemes. As a result, one can greatly increase post-retirement income while procuring a substantial current income tax deduction and other benefits previously mentioned.

Abuses of 412(i) Plans

Anything can be abused. One sees it daily in the news. 412(i) plans are no exception. Unfortunately, there are some very aggressive individuals and administrators that have abused these plans.

On February 13, 2004, Pam Olson, Assistant Secretary for Tax Policy at the Department of Treasury, was quoted during the release of Revenue Rulings addressing 412(i) plans as saying: ***"The guidance targets specific abuses***

occurring with section 412(i) plans," stated Assistant Secretary for Tax Policy Pam Olson. "There are many legitimate section 412(i) plans, but some push the envelope, claiming tax results for employees and employers that do not reflect the underlying economics of the arrangements."

To see more regarding this subject/article go to the web site here:
www.irs.gov/newsroom/article/0,,id=120409,00.html

Does your 412(i) plan have one or more of the following?

1. Different type of life policy on the principal(s) than on the rank-and-file?
2. Life insurance on the principal(s) and none on the rank-and-file?
3. A mix of policies from different carriers?
4. "Excess" life insurance? In other words, an amount of life insurance coverage on participant(s) that exceeds the allowable payout under Revenue Ruling 74-307 or Revenue Ruling 2004-20?
5. Term Life Insurance?
6. Universal Life Insurance?
7. Does your plan exclude more than 30% of the Non-highly Compensated Employees yet include all of the Highly Compensated Employees?
8. If you have employees who meet the age and service eligibility requirements, does your plan cover at least the greater of 2 participants or 40% of those employees?

If you answered "YES" to one or more of the above, your plan may be subject to IRS penalties or disqualification. You may even be subject to the Listed Transaction rules!

Did you know that the fine for a Listed Transaction can be as high as $200,000 under the American Jobs Creation Act of 2004? Did you know there is no provision for the fine to be waived?

What is the Solution?

We at RAM GROUP have always and will continue to work with TPA's that illustrate plans that meet the letter and spirit of the law. We are proud of the fact all plans we assisted with are compliant.

However, many plan sponsors and their advisors bring plans to us that are "abusive" by definition. Why do they seek our services? Because we have developed a division within our firm to diligently solve the problems these plans present to their sponsors.

Think your plan may be in jeopardy? Believe your plan may be, by definition, "abusive"? Have you been told "Don't worry about what you read, we have ways around that"? If so, you may want to contact us to discuss the issues.

To learn more about abuses and transactions contact RAM GROUP at 800-686-4238 and we will gladly provide additional articles and resources for education.

Frequently Asked Questions and Answers About Internal Revenue Code Section 412(i) Plans

I. Basics.

A. 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."

B. 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.

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

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

D. 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.

E. 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).

F. 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.

G. Does the IRS approve of these plans?

Yes. the TPA 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.

H. Is an enrolled actuary required?

No. However, many TPA's employ an enrolled actuary to ensure all plans are designed and administered within the spirit of the law.

II. Requirements.

A. 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.

B. 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.

C. 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.

D. 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.

III. Costs

A. 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.

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

“*The Insurance Compan*y” for all plan contributions and “*Third Party Administrator*” for the administration fees.

C. 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.

IV. Tax Benefits

A. 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.

B. 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).

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

No. All accumulations grow tax-free.

V. Funding

A. 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.

B. 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.

C. 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.

D. 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.

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

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.

VI. Distributable benefits

A. 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.

B. 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".

VII. Installation

A. What are the fees for a §412(i) Plan?

Design and Installation Fee (one-time): Determined by the 412(i) plan administrator

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

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

It's simple to have an illustration prepared. Here's how it works:

Step One: Complete the ***Producer Engagement Letter***
(If you've done this already and we have it on file, skip to Step Two)

Step Two: Print off the ***Data Request Form***. Fill it out and fax it back.

Step Three: Upon receipt we will call to discuss the data and get an idea of the presentation you wish to make to the client.

Step Four: In conjunction with an approved TPA we will prepare the illustration and send it to you via email in Read Only format. We will assist in the presentation to the client. We suggest you, the client and the client's CPA, and anyone else necessary to make a decision be at the meeting. In most cases the TPA will make the presentation and answer the questions your client and his/her advisors will have.

Step Five: Once the decision is made to move forward, the client completes and signs a ***Client Engagement Letter, Data Verification Form***, and mails back to the TPA with a check in the amount of the administration fees made payable to the TPA

The installation forms will be drafted and sent via email to you and the client.

For questions or more information call RAM GROUP at 800-686-4238.
www.rohrerandassociates.com

Important Note: The information in this section is only intended as a general overview and is not intended to provide tax or legal advice. There may be carrier, product or state variations or there may have been changes in the tax law or other laws that may affect the information in this section. Please consult a tax advisor for specific tax advice and proper legal counsel for legal advice. Also, please consult RAM Group and the TPA you are working with for specific carrier for specific product and state variations.

Example of an Actual 412(i) Case

Client Profile:

1. **Prominent Orthopedic Surgeon**
2. **Age 47**
3. **Surgeon's annual taxable income $800,000+**
4. **Employee ages 25,29, 36, 37**
5. **Two non-owner doctors ages 54 and 57 each earning $500,000+**

Client Desires:

1. **Maximize annual tax deduction**
2. **Protect assets from claim of judgment creditors**
3. **Minimize employee costs**
4. **Eliminate from participation two non-owner doctors**
5. **Build retirement funds as quickly as possible**
6. **Maximize tax-advantages**

Fact Pattern:

1. **7 Total employees**
   a. **Three doctors (one is the owner)**
   b. **Four employees**
2. **Existing 401(k) plan**

Outcome:

1. **412(i) plan covering the doctor/owner**
2. **Include two of the four rank-and-file employees**
3. **Balance of employees stay in the existing 401(k) plan.**

So…what does the 412(i) look like?

Name	Annuity Premium	Life Ins. Premium	Deposit	%
Dr. ABC	171,116	122,651	293,767	85.8
EE#1	12,274	11,595	23,869	7.0
EE#2	12,858	11,742	24,600	7.2
	196,248	145,988	342,236	

The balance of the employees will remain in the 401(k) plan.

The client's tax savings exceed $100,000!!

All of this is qualified under the Internal Revenue Code and the plans both obtain Favorable Determination Letters from the Service.

This is the time of year to speak to your clients on the benefits of implementing qualified plans to reduce their income tax liability.

Why should a client consider a 412(i) plan?

- **Contributions are income-tax deductible!**
- **Assets are protected from the claim of judgment creditors!**
- **Assets grow on a tax deferred basis!**
- **412(i) plans are invested such that deposits are guaranteed against market losses!**
- **Can accumulate as much as $2,000,000!**
- **Assets able to be rolled over, income-tax free, to one's IRA account!**