

What are 412(i) Plans?

The 412(i) plan is a defined benefit pension plan established under Section 412(i) of the Internal Revenue Code. It is a proprietary, custom-designed plan that can be used with any investment grade life insurance or annuity contract. The plan is governed by the Employee Retirement and Income Security Act of 1974 ("ERISA"), the federal act governing the funding, vesting, administration and termination of private pension plans. (29 U.S.C.A §1001 et.seq)

How do recent changes in 412(i) law benefit me?

Recent changes in the law have made the 412(i) plan more popular and more powerful as an estate, tax and retirement planning tool. Section 415(e) of the Internal Revenue Code, which limited the effectiveness of 412(i) plans, was repealed effective December 31, 1999. Section 415(e) required a complicated calculation which limited a participant's ability to fund a 412(i) plan. With a repeal of Section 415(e), a 412(i) plan may now be funded for retirement benefits of up to \$160,000 annually, beginning January 1, 2002. This makes it a far more powerful technique than IRAs, 401(k)'s, or profit-sharing plans for a business owner to plan aggressively for retirement while enjoying large immediate income tax deductions.

What are benefits of the 412(i) Plan for me and my company?

The 412(i) plan is appropriate for a small business owner who would like to take advantage of tax deductions granted to defined benefit pension plans. The plan is inexpensive to establish and maintain. Contributions to the plan are income tax-deductible to the company. The plan assets grow income tax-deferred and taxes are paid only when the benefits are distributed as retirement. Think of it this way: **for each dollar you contribute to a 412(i) plan, the government funds thirty to forty cents for your retirement through the available tax deduction.** While growing income-tax deferred, your plan assets are protected from the claims of your creditors. In addition, the government permits you to contribute substantially more money to your 412(i) plan than to an IRA, 401(k) or profit-sharing plan. Your plan benefits are fully guaranteed by the life insurance or annuity contract(s) owned by your plan. (see below)

Low costs to Implement. Unlike other defined benefit pension plans (such as, for example, Boeing's company plan), no Pension Benefit Guaranty Corporation (PBGC) insurance is required with a 412(i) plan because the benefits are guaranteed by the insurance company. This reduces the cost of the plan. Also, in non-412(i) plans a Plan Actuary must perform complicated calculations to determine the contributions which are required to create the desired retirement income stream. The Plan Actuary's calculations are not necessary with 412(i) plan because the benefits are guaranteed by the insurance company. This simplifies and reduces the cost of the plan. In addition, your sole proprietorship, S or C Corporation, family limited partnership (FLP) or family limited liability company (LLC) can adopt the 412(i) defined benefit pension plan. And, as an added benefit, your 412(i) plan can eliminate estate taxes on an IRA! (See discussion below)

In Summary, The benefits of your 412(i) plan are:

- You receive immediate income tax deductions.
- Your plan assets grow income tax-deferred.
- You are permitted to make large plan contributions.
- Your plan assets are creditor-protected.
- Your plan can eliminate estate taxes on your IRA.
- Your plan benefits are fully guaranteed by a major insurance carrier.
- Your C or S Corp, FLP or LLC can adopt the plan.
- No Plan Actuary or PBGC insurance is required.
- Your plan is governed by ERISA and registered with the I.R.S.
- Your plan is inexpensive to establish and maintain.

How is the 412(i) Plan designed?

The 412(i) Plan is designed by determining how much annual income you will need at retirement and then calculating the annual contributions which will be required to reach that goal. The U.S. government allows you to plan for substantial annual retirement income of up to \$160,000 with the 412(i) Plan and permits a tax deduction for contributions which are made to the plan to meet this retirement goal.

How does the 412(i) Plan affect my employees*?

Since it is governed by ERISA, your 412(i) plan must allow employees to participate in the plan. Employee benefits are determined by a variety of factors. For example:

1. Employees must be over 21 to participate;
2. Employees must stay with the company for a period of 3 years or 6 years

(depending upon the vesting schedule) to become 100% vested in their benefits;

3. Employees might have most of their benefits paid for by Social Security so that you do not have to contribute to the plan for them;
4. Employees must work over 1000 hours each year; and
5. Employees must not benefit from a union plan.

*Where the business entity is a family C or S Corp, FLP or LLC, "employees" are likely to be you and your children.

How do I fund my 412(i) Plan?

Your 412(i) plan is funded with retirement annuities or investment grade life insurance contracts. These investment assets make security and simplicity the hallmarks of the 412(i) Plan. As an example, Indexed Annuities or Indexed Life Insurance can allow you, as the investor, to receive a guaranteed 2-4% interest on your account or 80-90% of the annual return of the Standard & Poor's 500, whichever is greater. This arrangement protects both your downside and your equity upside. While your retirement benefits are calculated on the guaranteed part of the contract, the historic return on Indexed Annuities generally exceeds that guaranteed rate, so your returns could exceed the guarantee.

How does the 412(i) Plan provide retirement benefits?

The cash surrender value of the insurance contract can be converted into an income stream of up to \$160,000 per year for life for each participant.

How does the 412(i) Plan provide disability benefits?

Following the onset of a disability the cash value of the insurance contract can provide disability income. Fully-funded, the disability income for each participant can be as high as \$11,250 per month for the rest of the participant's life.

How does the 412(i) Plan provide income replacement upon a participant's death?

The 412(i) Plan, fully-funded, can provide your surviving spouse or children up to \$11,250 per month for the rest of their lives.

How may I take distributions from my 412(i) Plan?

Before reaching age 59 1/2, you may take penalty-free distributions as long as they are uniform, systematic distributions based upon your life expectancy. A pre-59 1/2 lump sum distribution will trigger a penalty of 10% of the amount distributed (the I.R.C. Section 72(t) penalty), plus applicable income taxes. If you have reached age 70 1/2 and you are retired you must take the required minimum distribution from your plan (the calculated annual planned benefit). If you have reached age 70 1/2 and you are not retired you may defer distributions until your retirement.

If I am already retired, may I contribute to my 412(i) Plan?

Yes, if you are already retired or are over age 70, you can contribute to your 412(i) Plan for up to five years, under certain circumstances.

Are my 412(i) Plan contributions subject to the Alternative Minimum Tax (AMT)?

No. Contributions to your 412(i) Plan are not subject to AMT, and might lower your overall exposure to AMT. This is a powerful tax saving opportunity.

With a 412(i) Plan can I receive an income tax deduction in excess of my salary?

Yes, you can receive an income tax deduction in excess of your salary. Generally, all types of compensation are used in calculating the formula for determining benefits in a 412(i) plan. This includes: base salary; bonuses; vacation pay; overtime; and any other compensation that meets your definition as the employer. In addition, amounts that you contribute to a 401K plan, a Section 125 ("cafeteria") plan or a Section 127 (education assistance) plan can be used in determining the total allowable contribution you may make to your 412(i) plan.

Are the assets in my 412(i) Plan protected from lawsuits and creditors?

Yes, your plan is creditor-protected. A properly drafted 412(i) plan is an ERISA defined benefit pension plan. As such, its assets are fully immune from the claims of creditors. The most notorious, widely publicized example is the O.J. Simpson case. O.J. Simpson enjoys his daily round of golf in Florida and his \$25,000 monthly NFL pension benefit, even in the face of an outstanding \$30 million civil judgment returned against him in California holding him responsible for the deaths of Nicole Brown Simpson and Ronald Goldman.

How can I eliminate federal estate taxes on my IRA using my 412(i) Plan?

You can eliminate federal estate taxes on your IRA by using a powerful technique called an IRA "Rollback". You "roll back" your conduit IRA (i.e., an employer-sponsored IRA to which you have not made \$2000 annual contributions) into your 412(i) Plan. (Effective January 1, 2002, you can rollback an IRA even if it has been "tainted" by one or more \$2000 contributions.) You (along with your spouse) elect a Qualified Joint and Survivor Annuity (QJSA). Upon your deaths the plan benefits are forfeited back to the other plan members (presumably your children). Your estates owe no estate taxes on the proceeds forfeited back to the plan. In addition, the forfeiture of the assets back to the plan reduces future contributions required to be made by the surviving plan participants (your children).

Is my private family foundation permitted to adopt my 412(i) Plan?

Yes, your family foundation may adopt the 412(i) Plan for any employee (e.g., you , your children or any other foundation employees). A non-qualified deferred compensation plan might be a suitable alternative.

Can I amend my 412(i) Plan?

Yes, your plan may be amended. If a plan amendment will result in a significant reduction in the rate of future benefit accruals, the plan administrator must notify all participants, certain beneficiaries, and any union representing plan participants. The required written notice is often referred to as the 204(h) notice. For example, if your plan changes the definition of compensation in a way that would lower benefits, a 204(h) notice is required.

Can I terminate my 412(i) Plan?

Yes. As plan sponsor, you may terminate your 412(i) plan as long as the plan document provides for termination. In general, a plan must be fully funded and there must be a bona fide business reason for the plan termination, including: a change of ownership of the business by merger; the liquidation or dissolution of the employer; a change in ownership through sale or transfer; the existence of adverse business conditions; and the adoption of a new plan. Upon termination, plan proceeds may be rolled over into an IRA, tax-deferred.

What documents must be prepared to establish the 412(i) Plan?

The documents required to prepare your 412(i) Plan are:

- Census
- Adoption Agreement
- Summary Plan Description (for employees)
- Plan trust instrument
- I.R.S. Tax Determination Letter

If you would like to learn more about the 412(i) Plan and whether it is appropriate for your circumstances and goals, please contact us. Our initial consultation with you is offered on a complimentary basis. We look forward to meeting with you.