

412(i) FULLY INSURED DEFINED BENEFIT PLANS

IN

QUESTION AND ANSWER FORMAT

What is a 412(i) defined benefit pension plan?

A 412(i) defined benefit pension plan, referred to in IRS regulations as an “insurance contract plan”, is the only defined benefit plan that is exempt from the minimum funding requirements of Section 412 of the internal revenue code. This type of plan, therefore, enjoys certain advantages over the traditional defined benefit plan and is worth exploring if you are the owner of a small business.

These advantages create a plan that, compared to a traditional defined benefit plan, will produce:

- larger initial deductions
- more stability in the contribution level,
- simpler plan administration, and
- a secure promise of future benefits guaranteed by an insurance company.

What are the advantages of a 412(i) insurance contract plan over a “traditional” defined benefit plan?

A 412(i) insurance contract plan:

- does not require an enrolled actuary;
- is not subject to the full funding limitation tests of a defined benefit plan;
- is required to use the contract guarantees as funding assumptions, thus shielding them from IRS attack as unreasonable funding assumptions;
- can be designed to eliminate the potential of excess plan assets that, in a traditional plan, would be subject to taxes and penalties of 80% or more upon termination of the plan;
- produces an understandable accrued benefit since it is simply the cash value of the contracts funding the participant’s account;
- creates larger initial deductions than a traditional plan since the funding assumptions are required to be much more conservative; and
- provides retirement benefits that are guaranteed by the insurance company and not just the financial strength of the particular employer providing the plan.

What requirements must be met to qualify as a 412(i) insurance contract plan?

The major requirements under Section 412(i) of the Internal Revenue Code are:

- The plan must be funded exclusively with annuity products, or a combination of life insurance and annuity products, issued by an insurance company.
- The benefits provided each individual must be equal to the values provided in the contracts and guaranteed by the insurance carrier.
- Life insurance dividends and excess annuity interest must be used to reduce the following year’s plan contribution.
- No policy loans are allowed under the contracts.

How does the initial deductible contribution required in a 412(i) plan compare to a traditional defined benefit plan?

Generally, a plan funded with only annuity contracts may DOUBLE the deductions allowed under a traditional plan. A plan funded with both annuity and the maximum life insurance allowed may TRIPLE the deduction allowed in a traditional defined benefit plan. See the appendix page that illustrates the maximum first year contribution levels for a 412(i) plan funded with ANICO products. These contribution levels are shown from ages 35 to 65. Comparisons are made for plans funded entirely with annuity contracts and those funded with a combination of annuity and the maximum amount of life insurance available under the incidental insurance rules for qualified plans.

Are 412(i) plans new to the retirement planning marketplace?

No. These plans have been around since ERISA (in 1974) or even before. They were referred to as “fully insured defined benefit plans”. In past years, before the demise of retirement endowment contracts, they were fully funded with a retirement endowment contract issued with a face amount equal to 100 times the normal retirement benefit. They are not a “grey area” of the law and are, in fact, a very conservative approach to retirement plan funding. All benefits are guaranteed by an insurance company.

Where do you go to find a 412(i) plan?

Generally, you will go to an insurance company that sells these types of plans. The funding must be in insurance company products and the company must guarantee the benefits. There are very few insurance companies who market and administer small business retirement plans so there are very few companies that market 412(i) plans. That is why it is a plan that is somewhat unfamiliar to most CPA’s and small business owners.

Why does American National market these plans?

We believe it is a market that is under-served. We specialize in the small business retirement plan marketplace. We design, administer, and fund plans for the small business. It is, therefore, natural that we market 412(i) plans. These are specialized plans that create large deductions. In the right situation, there is no other plan that will meet the needs of the small business owner. If a traditional defined benefit plan does not create sufficient deductions, there is nowhere else to turn but to a 412(i) fully insured plan.

What products are utilized at American National for these plans?

We have available a Whole Life product and a Life Paid Up at 65 product as well as both an individual and group fixed annuity for this marketplace.

Do the contributions remain level forever?

The contributions will gradually decrease since the excess interest earned over the guaranteed rate must be used to reduce the following year’s contribution. The dividend payable on the life policy will also be used to reduce the following year’s contribution. However, if the deduction decrease becomes a problem, it is likely the plan benefit can be increased to compensate for that since the maximum benefit levels are subject to annual cost of living increases declared each year.

What does American National charge to administer these plans?

We charge \$200 to establish the plan which includes providing the plan and trust document and providing the plan trustee with a manual including all documents and administrative forms that may be needed in the future. Annually, we charge \$700 to provide full administration (\$600 if a one person plan). The full administration includes all IRS and DOL forms and the plan valuation and 5500 forms required. The forms will be prepared and ready for the trustee to sign and mail each year to the proper government agency. Note that for new plans established in 2002 and thereafter, the new tax law (EGTRRA) allows a **50% tax credit** for the first three plan years for administrative expenses (up to the first \$1,000 of expenses).

What is necessary to see if a plan is feasible for you?

American National will provide a FREE feasibility study to see if a plan fits your situation. All that is needed from you is a census of all employees of the firm.

Who is the best prospect for this type of plan?

Generally, it will be a firm with 5 or less employees where the owner is at least age 50 and earns a very high, consistent income. The ideal prospect is an independent contractor with no employees.