412(e)(3)
Frequently Asked Questions

WHAT IS A 412(E)(3) PLAN?

A 412(e)(3) Plan is a defined benefit pension plan guaranteed with insurance company annuity and life insurance contracts. A 412(e)(3) Plan is also known as a "fully insured defined benefit plan".

WHAT IS THE DIFFERENCE BETWEEN A 412(E)(3) PLAN AND A TRADITIONAL DEFINED BENEFIT PLAN?

A 412(e)(3) Plan invests exclusively in permanent life insurance and annuity contracts with guaranteed rates of return. A traditional defined benefit plan can invest in term or permanent insurance, annuity contracts or other investments like mutual funds and stocks. A 412(e)(3) Plan protects participants and employers against poor investment performance.

WHAT IS THE ADVANTAGE OF A 412(E)(3) PLAN?

A 412(e)(3) Plan protects employers and employees from market fluctuations and provides maximum flexibility and security for retirement planning. Since the benefits in a 412(e)(3) Plan are guaranteed by an insurance company, the investment return is generally more conservative; meaning that a plan sponsor can make contributions as much as 3x greater than to a traditional defined benefit plan. A 412(e)(3) Plan permits an employer to "fast fund" a retirement plan for older employees without increasing costs for younger employees.

HOW DOES A 412(E)(3) PLAN WORK?

The Plan purchases a combination of annuity and life insurance contracts or just annuity contracts, with underlying guaranteed returns, to provide retirement benefits to eligible employees. Because benefits are guaranteed by the insurance company, the Plan has no investment risk. Benefits are level-funded over the working life of each employee. At retirement, the promised benefit is ready to be used by the retiring employee.

WHAT ARE THE REQUIREMENTS UNDER 412(E)(3)?

A 412(e)(3) Plan must be funded exclusively with guaranteed insurance products. These can be annuity contracts or a combination of life insurance and annuity contracts. The contracts must provide for level annual premium payments until retirement. An employee's benefit is provided by the insurance contracts and is guaranteed by the insurance company to the extent premiums are paid. Loans are not allowed and no rights under the contracts may be subject to a security interest during the year. Gains to the plan must be used to reduce future contributions.

WHAT IS THE MAXIMUM BENEFIT IN A 412(E)(3) PLAN?

The maximum benefit for 2016, with a retirement age from 62-65, is the lesser of 100% of salary or $17,500/month, reduced by 1/10th for each year of participation less than 10.

IS A 412(E)(3) PLAN SAFE?

Yes. A 412(e)(3) Plan is the safest type of retirement planning. Contributions are invested in guaranteed annuity and life insurance contracts, thereby eliminating investment risk for both the employer and the employee. In addition, 412(e)(3) Plan documents are IRS approved prototype. The prototype has received a determination letter from the IRS.

WHAT IS THE ADVANTAGE OF USING CONTRACT GUARANTEES TO DETERMINE THE FUNDING?

The primary advantage is that the ultimate benefit, as well as annual premiums, is guaranteed by the insurance contract. In addition, contract guarantees are generally much lower than the interest rate used to calculate funding for a traditional defined benefit plan. This results in larger contributions to a 412(e)(3) Plan.

HOW ARE THE CONTRIBUTIONS TO A 412(E)(3) 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 age (NRA) is determined and, then, using the guaranteed interest rate under the contract, the annual level premium needed to reach the target at retirement is calculated.

> For example, assume your client is 55 years old with an NRA of 65, and that $100,000 is needed to pay the promised retirement benefit. At a 1% interest rate, the company would fund $9,464 a year for 10 years to reach the target amount.

HOW MUCH CAN A "TYPICAL CLIENT" CONTRIBUTE TO A 412(E)(3) PLAN?

An employer's contribution will depend upon the ages and years to normal retirement age of its employees. However, because of the conservative nature of life insurance and annuity guarantees, contributions to a 412(e)(3) Plan may be as much as 200% more than contributions to a traditional defined benefit pension plan and 800% more than contributions to a defined contribution plan.

For example, assume that your client is 55 years old and wants to make the maximum contribution to a pension plan. If his NRA is 65, he can contribute about $447,552 a year to a 412(e)(3) Plan and even more if his NRA is 62. On the other hand, his maximum contribution to a traditional defined benefit pension plan would be closer to $210,581.

ARE CONTRIBUTIONS TO A 412(E)(3) PLAN TAX-DEDUCTIBLE?

Yes. An employer's contributions to a qualified retirement plan are generally tax-deductible by the employer. An employee does not pay tax until the benefit is actually received.

IS THERE A TAX ON THE INTEREST RATE GROWTH/ACCUMULATIONS IN THE PLAN?

No. All accumulations grow tax-free.

ARE PLAN SET-UP AND ADMINISTRATION FEES DEDUCTIBLE?

Yes.

IS THERE ANY COST TO AN EMPLOYEE?

No. There is no cost to the employee. However, if a 412(e)(3) Plan provides a death benefit through the purchase of life insurance, an employee will recognize the "current economic benefit" of the death benefit as taxable income. The "current economic benefit" is calculated using Table 2001. Each year, the Plan Administrator provides the Table 2001 rates for each employee.

IS AN ENROLLED ACTUARY REQUIRED?

No. Because a 412(e)(3) Plan's benefit is guaranteed by the insurance company, the Plan can never be under-funded. Therefore, there is no need to have an enrolled actuary certify that the Plan is adequately funded.

DOES THE COMPANY HAVE TO PAY FOR PBGC (PENSION BENEFIT GUARANTEE CORPORATION) INSURANCE?

PBGC premiums are a limited to a flat rate of $64.00 per plan participant.

WHO PAYS FOR A 412(E)(3) PLAN?

The employer, which term includes a sole proprietor, makes the plan contributions, as well as paying the minimal set-up and administrative fees.

IF AN EMPLOYER HAS OTHER PENSION PLANS, CAN IT ADOPT A 412(E)(3) PLAN?

Yes. How this is achieved depends on the employer's existing plans. Call us for specifics. However, in general, the following rules apply:

> **401(k) Plan**: After 1/1/02, a company can retain its 401(k) plan for employee contributions and adopt a 412(e)(3) Plan.
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> **Profit Sharing Plan**: The profit sharing plan can continue. The contribution to the profit sharing plan may be limited to 6% of covered compensation if the 412(e)(3) plan is not covered by the PBGC. The full 412()(3) plan contribution can be made. Contact your regional for more details.
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> **Defined Benefit Plan**: We strongly recommend that the employer terminate its defined benefit plan before adopting a 412(e)(3) Plan. The accrued benefit of the terminated DB plan will lower the maximum benefit of the new 412(e)(3) plan.

WHO CAN ADOPT A 412(E)(3) PLANS?

Any business entity, including partnerships, corporations, and sole proprietors, can adopt a 412(e)(3) Plan. A 412(e)(3) Plan works best for businesses with fewer than 15 employees, whose owners are at least age 45. A 412(e)(3) Plan is a good planning tool for any business seeking to maximize retirement benefits on a tax-deductible basis. Talk to your Regional Director for details.

CAN I DESIGN A 412(E)(3) PLAN TO "SPEND" AT A CERTAIN LEVEL?

Yes. Contributions can be made at whatever rate your client is comfortable with. Talk with your Regional Director about designing plans to meet your client's needs.

IF MY CLIENT HAS A BAD YEAR CAN IT SKIP A YEAR OF FUNDING?

No. A 412(e)(3) Plan must be funded each year. However, plans can be amended, frozen or terminated to accommodate your client's needs.

WHO DOES THE EMPLOYER HAVE TO INCLUDE IN THE PLAN?

All full-time, non-union employees are covered. The employer can exclude part-time employees (less than 1000 hours), employees younger than age 20 1/2 or who have less than one year nearest of service (six months) with the company. A service requirement of two years nearest (18 months) may be used with immediate vesting. Using additional coverage testing certain employees may be excluded. Talk to us about Carve-out and Offset plan designs.

DO THE AFFILIATED SERVICE AND CONTROLLED GROUP RULES OF IRC 414 APPLY?

Yes. All eligible employees of controlled groups and affiliated service groups must be included in the Plan.

WHAT HAPPENS TO THE LIFE INSURANCE IN A 412(E)(3) PLAN AFTER AN EMPLOYEE RETIRES?

An employee may continue his life insurance benefit by taking the policy as a plan distribution and recognizing the policy's fair market value as taxable income, by taking a reduced paid-up policy or by buying the policy from the Plan. If there is no need for the life insurance, the policy can be surrendered by the plan for its cash value.

If an employee keeps the life insurance in place, the policy will be individually owned and, with proper planning, the proceeds may be excluded from estate tax. Some policies allow for conversion to other permanent contracts, which may allow for additional options.

For more information, contact our headquarters at **+1.888.599.5553** or visit our website at **rmcgp.com**.

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