

412(i) Plans

How They Work and When to Use Them

***412(i) has been renumbered 412(e)(3) by the Pension Protection Act of 2006**

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- ▶ MassMutual, its employees and representatives are not authorized to give tax or legal advice. Individuals are encouraged to seek advice from their own tax or legal counsel.
- ▶ A 412(i) plan must be funded exclusively with individual insurance products, either fixed annuities or a combination of fixed annuities and life insurance.
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Overview

- ▶ The 412(i) is a defined benefit plan. This means that the contribution to the plan is determined based on the benefits to be paid at retirement.
- ▶ The plan must be, of course, sponsored by an employer.

Non-Discriminatory

- ▶ Because a 412(i) plan is a type of qualified plan, it must not be “discriminatory.”
- ▶ It must cover all eligible employees.

Establishment of the Plan

- ▶ Plan is easy to establish.
- ▶ Prototype and Volume submitter documents are available for § 412 (i) plans.
- ▶ Plan can be established by “S” Corporation, C Corporation, Limited Liability Company, Partnership or Sole Proprietor.

What is Special About 412(i) Plans?

- ▶ IRC § 412 is entitled “*Minimum Funding Standards.*”
- ▶ This section sets out the complex rules for determining the funding of Defined Benefit Plans.
- ▶ Each year, a Defined Benefit Plan has to be reviewed and the present value of liabilities for benefits must be determined by an actuary.

Fully Insured Plans Under §412(i)

- ▶ 412(i) is an exception to the general rules of §412.
- ▶ With a 412(i) plan, the insurance company's guarantees* take the place of the actuarial analysis mandated by §412.

▶ *Guarantees are subject to the claims paying ability of the issuing company.

Impact of Qualifying Under §412(i)

- ▶ No minimum funding standard account.
- ▶ No full funding limitation.
- ▶ No quarterly contributions required.
- ▶ No reasonable actuarial assumptions.
- ▶ No Schedule B Form 5500 Enrolled Actuary Certification needed.

Qualification Under §412(i)

- ▶ The plan must be funded entirely with fixed annuities, or fixed annuities and life insurance;
- ▶ The contracts must provide for guaranteed level annual premiums to be paid during anticipated normal working years;

Qualification Under §412(i)

- ▶ The benefits must be guaranteed by an insurance company;
- ▶ The premiums for the current and all prior years have been paid;
- ▶ The plan cannot have any outstanding loans;
- ▶ The performance in excess of guarantees must be used to reduce future contributions.

Why are §412(i) Plans becoming Popular?

- ▶ They can generate large deductions because contributions are based on the insurance company guarantees.
 - ▶ Guarantees are subject to the claims paying ability of the insurance company.
- ▶ Retirement Benefits can be paid to a maximum of \$180,000 annually at age 62 (reduced from 65 by EGTRRA*).

Why are §412(i) Plans becoming Popular? (Cont)

- ▶ Guaranteed benefits* not subject to the ups and downs of the stock market.

*Guarantees are subject to the claims-paying ability of the issuing companies.

Life Insurance in a §412(i) Plan

- ▶ Life Insurance contracts can be used in addition to annuities.
- ▶ Life Insurance is subject to the “incidental benefit” limitation generally applicable to defined benefit plans:
 - ▶ Treas. Regs limit face amount to 100 times anticipated monthly benefit; or
 - ▶ Rev. Rul. 74-307 allows up to less than 50% of contribution toward ordinary life premium.

Why have Life Insurance in Plan?

- ▶ Can provide an additional death benefit.
- ▶ The “Economic Benefit” is taxable each year.
- ▶ IRC 72(m)3(b), Reg. Sec. 1.72-16(b): each participant is taxed on the “pure” life insurance benefit.
- ▶ The “pure” insurance is received income tax free by participant’s beneficiaries.

Contribution Examples

- ▶ The following examples are all based on the guaranteed rates of the MassMutual Odysseysm Annuity and Pension Limited Payment Whole Life Policy (paid-up at 65). The Guarantees are subject to the claims-paying ability of the issuing companies.
- ▶ MassMutual Odyssey® (Policy Form #: MUFA99 or MUFAC99) is a fixed annuity contract issued by Massachusetts Mutual Life Insurance Company in New York and by C.M. Life Insurance Company in all other states. C.M. Life Insurance Company, 100 Bright Meadow Boulevard, Enfield, CT 06082, is non-admitted in New York and is a subsidiary of Massachusetts Mutual Life Insurance Company, 1295 State Street, Springfield, MA 01111-0001.
- ▶ Life Paid-Up at Age 65 (LPL 65) Whole Life Insurance (Policy Form 123-9400 and 123-NC-9400 in North Carolina) is a level-premium, permanent life insurance policy issued by Massachusetts Mutual Life Insurance Company, Springfield, MA 01111-0001
- ▶ The illustrations used in this presentation are purely hypothetical and are used solely to demonstrate the general concept of 412(i) plans.

Example for 42 Year Old (unisex - preferred non smoker)

Retirement age of 65 and an anticipated retirement benefit of \$10,000 per month and LPL 65 –100 x monthly benefit.

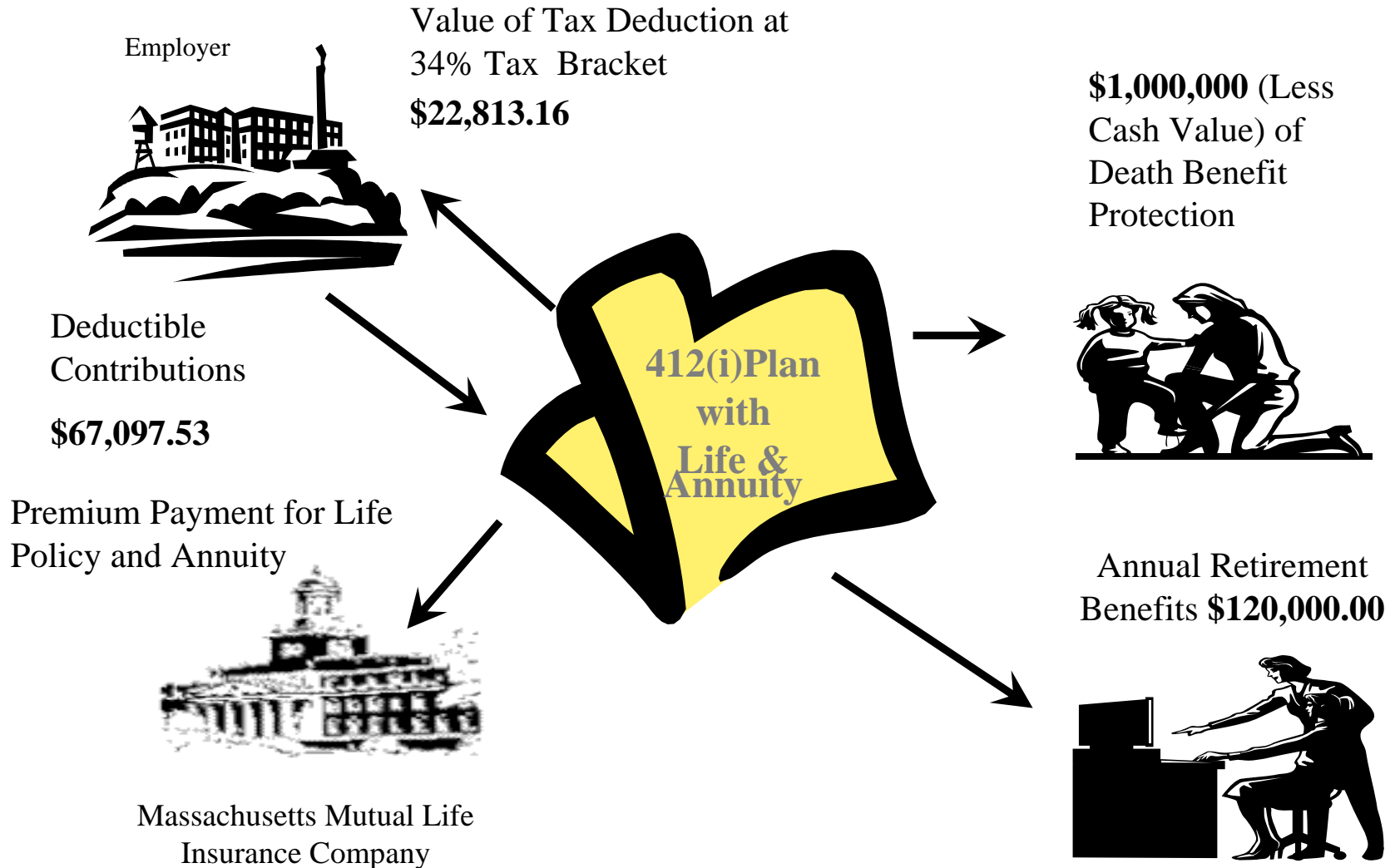
- ▶ Value required at retirement to produce life only monthly benefit (based on annuity purchase rate in MassMutual Odysseysm) 1,996,008
- ▶ Face amount of life Insurance policy 1,000,000
- ▶ Life insurance policy Premium 23,760.00
Premiums are payable to age 65
- ▶ Level annual annuity payment 43,337.53

Total annual outlay

(annuity premium + life insurance premium) \$67,097.53

***Dividends are not guaranteed and are subject to significant fluctuations over the lifetime of a policy.**

Scenario #1: How it Works



Example for 42 Year Old (unisex - preferred non smoker)

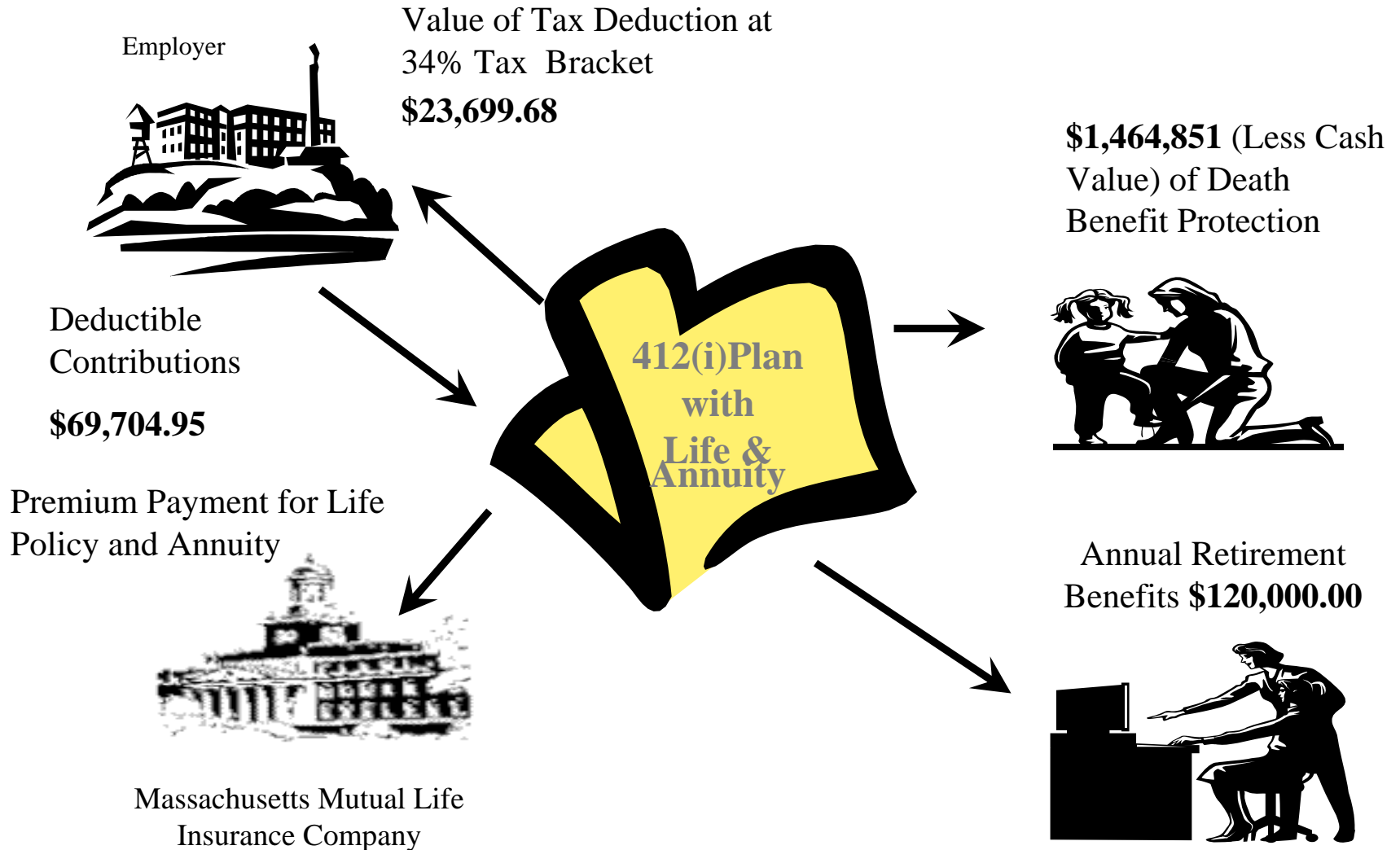
Retirement age of 65 and an anticipated retirement benefit of \$10,000 per month and LPL 65 based on less than 50% of contribution.

- ▶ Value required at retirement to produce life only monthly benefit (based on annuity purchase rate in MassMutual Odysseysm) 1,996,008
- ▶ Face amount of life insurance policy 1,464,851
- ▶ Life insurance policy Premium 34,781.62
Premiums are payable to age 65
- ▶ Level annual annuity premium 34,923.33

Total annual outlay

(annuity premium + life insurance premium) \$69,704.95

Scenario #2: How it Works



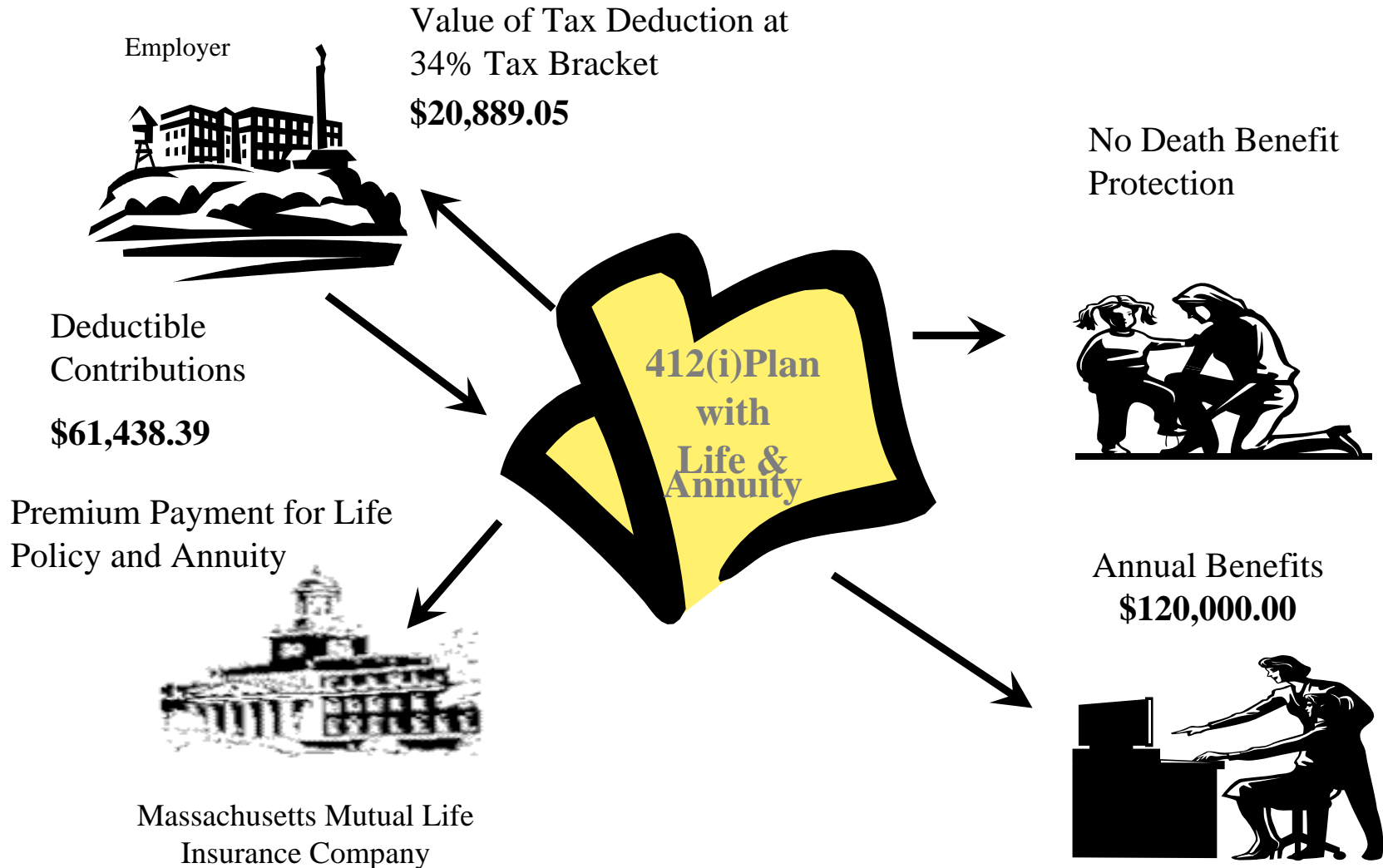
Example for 42 Year Old (unisex)

Retirement age of 65 and an anticipated retirement benefit of \$10,000 per month and no life insurance.

Policy: MassMutual Odysseysm Fixed Annuity

- ▶ Anticipated Monthly Benefit 10,000.00
- ▶ Value required at retirement to produce life only monthly benefit (based on annuity purchase rate in MassMutual Odysseysm) 1,996,008
- ▶ Level annual annuity payment **61,438.39**

Scenario #3: How it Works



Example for 52 Year Old (unisex - preferred non smoker)

Retirement age of 65 and an anticipated monthly retirement benefit of \$10,000 and funded with LPL-65 - 100 x monthly benefit.

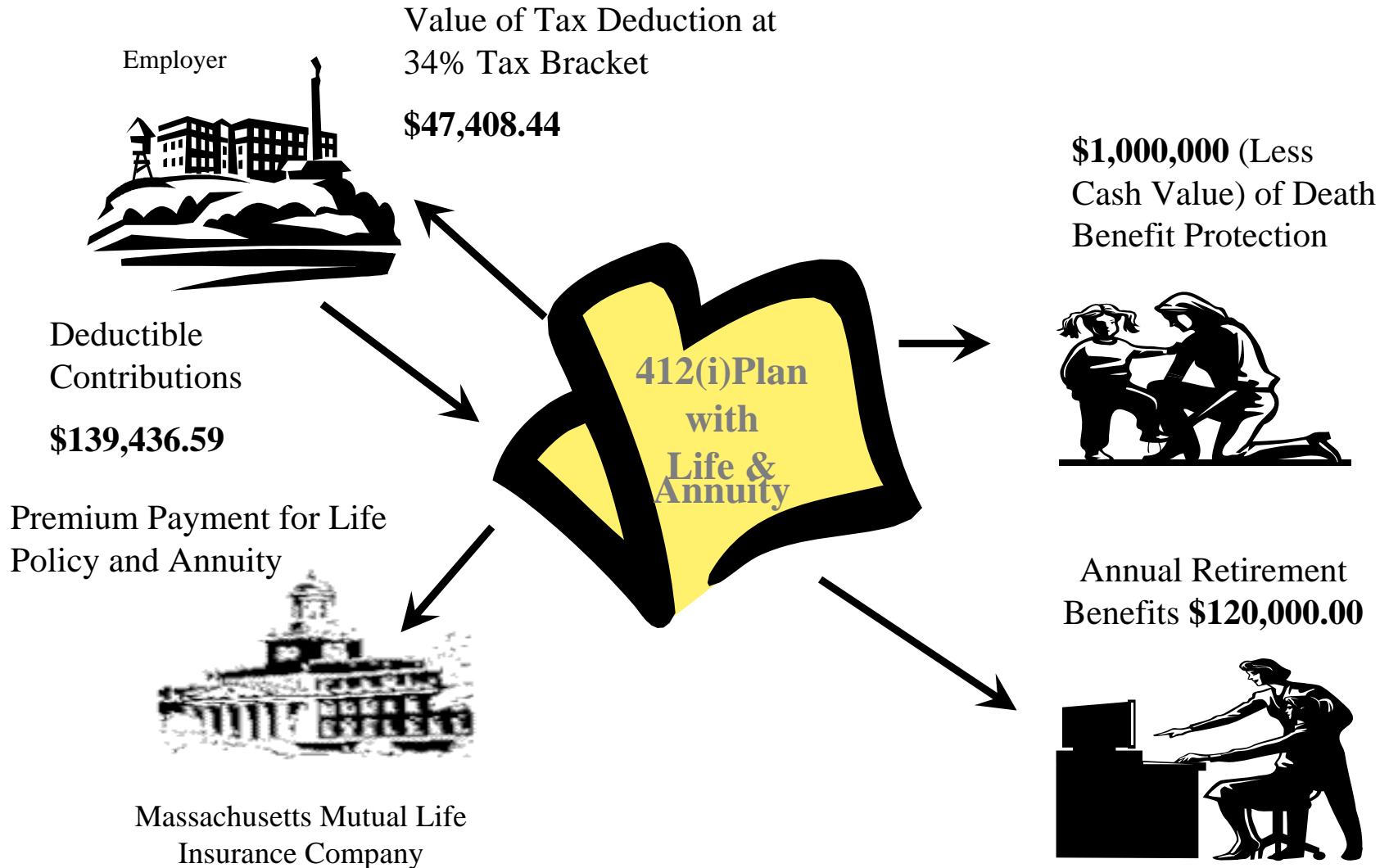
Policy: MassMutual Odysseysm Fixed Annuity

- ▶ Value required at retirement to produce life only monthly benefit (based on annuity purchase rate in MassMutual Odysseysm) 1,996,008
- ▶ Face amount of life insurance policy 1,000,000
- ▶ Life insurance policy Premium 47,940.00
Premiums are payable to age 65
- ▶ Level annual annuity payment **91,496.59**

Total annual outlay

(annuity premium + life insurance premium) \$139,436.59

Scenario #1: How it Works



Example for 52 Year Old (unisex - preferred non smoker)

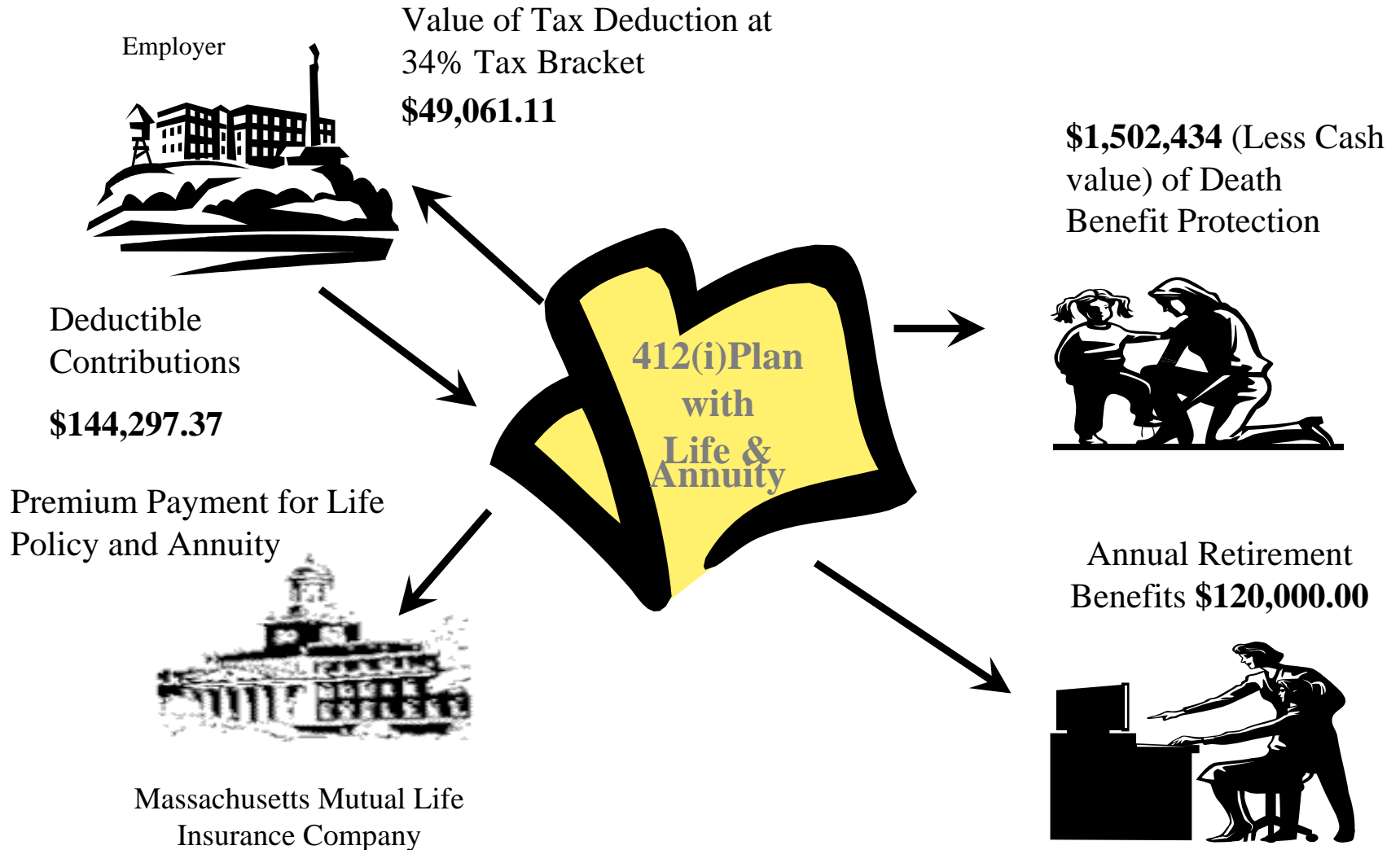
Retirement age of 65 and an anticipated retirement benefit of \$10,000 per month and funded with LPL-65 limited by Rev. Rul. 74-307.

▶ Anticipated Monthly Benefit	10,000.00
▶ Value required at retirement to produce life only monthly benefit (based on annuity purchase rate in MassMutual Odyssey sm)	1,996,008
▶ Face amount of life insurance policy	1,502,434
▶ Life insurance policy Premium Premiums are payable to age 65	72,001.57
▶ Level annual annuity payment	72,295.80

Total annual outlay

(annuity premium + life insurance premium) \$144,297.37₂₄

Scenario #2: How it Works



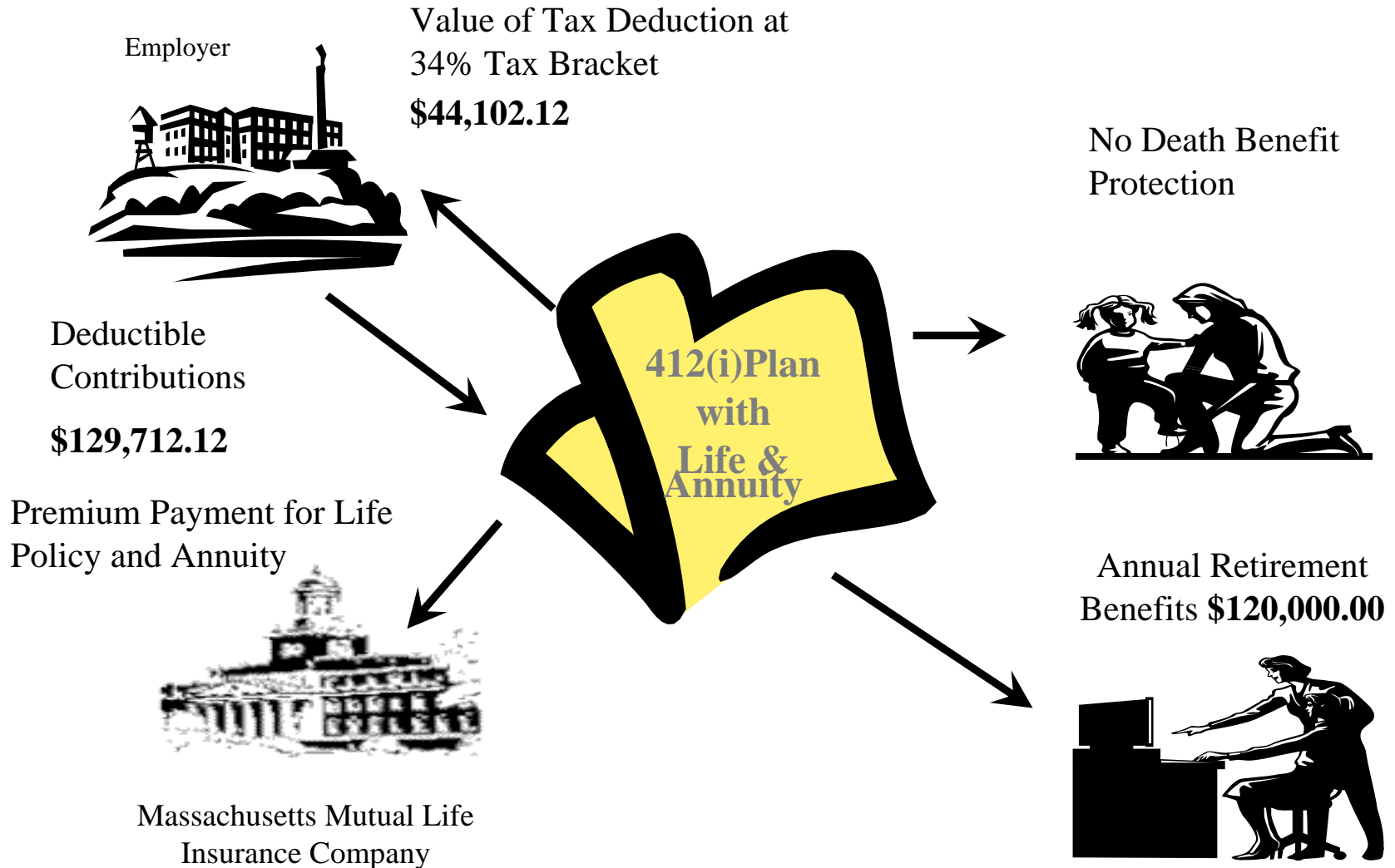
Example for 52 Year Old (unisex)

Retirement age of 65 and an anticipated monthly retirement benefit of \$10,000 and no life insurance.

Policy: MassMutual Odysseysm Fixed Annuity

- | | |
|---|--------------|
| ▶ Anticipated Monthly Benefit | 10,000.00 |
| ▶ Value required at retirement to produce life only monthly benefit (based on annuity purchase rate in MassMutual Odyssey sm) | 1,996,008 |
| ▶ Level annual annuity payment | \$129,712.12 |

Scenario #3: How it Works



Investment Performance of Policies

- ▶ If annuity generates income in excess of guarantee, that increase is used to reduce next year's premium.
- ▶ Dividends in excess of guarantee on life insurance policy must be used to reduce premiums.
- ▶ To the extent performance exceeds guarantees, the costs of the plan will be reduced over time.

*Dividends are not guaranteed and are subject to significant fluctuations over the lifetime of the policy.

What type of Products to Put in Plan

- ▶ For annuities, a fixed annuity must be used.
- ▶ For life insurance, a whole life policy with cash guarantees is appropriate.

Does GATT Effect 412(i) Plans?

- ▶ The Retirement Protection Act of 1994 (a part of the GATT Legislation) limited the maximum lump sum payable with its own specified interest rate and mortality.
- ▶ Under most circumstances the “GATT” rate will result in a reduction of maximum amount that can be paid in the form of a lump sum.

Overfunding

- ▶ The practical effect of this is that a §412(i) plan may become overfunded.
- ▶ If a termination occurs when the plan is overfunded, the excess assets are taxable to the employer and the plan could face tax penalties of as much as 50%.

Strategies to Avoid Overfunding

- ▶ After the 412(i) plan has been in effect for several years, the plan can be converted to a “regular” defined benefit plan.
- ▶ This will mean having an enrolled actuary and complying with the funding limitations.

Strategies to Avoid Overfunding

- ▶ The plan post conversion will probably be “overfunded” and should come back in line with funding limits as years pass without contributions being made.
- ▶ Fund to less than the maximum allowable benefit. If funded to 65% of maximum benefit the plan may avoid overfunding for lump sum distribution purposes.

What Employer Should Consider a §412(i) Plan?

- ▶ Business owner age 50 and older with young (or no) employees.
- ▶ Employers with few eligible employees.
- ▶ Employers with substantial and steady amounts of taxable income.
- ▶ Employers with younger and lesser paid “non-key” employees.

Conclusion

- ▶ The 412(i) plan, in the appropriate situation, is a powerful tool to reduce income taxes by generating large deductions and provide a certain retirement benefit.

Contacts

- ▶ **Advanced Sales Concept Support: 800-234-2865, X21215**
- ▶ **Blue Chip Group Support: 800-234-2865, X21234**
- ▶ **Estate & Business Planning Support: 800-234-2865, X22257**
- ▶ **Annuity Sales Support: 800-234-5606, press 3 and provide agency number for appropriate internal wholesale contact**

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Questions



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