

AN OVERVIEW OF SPLIT FUNDED DEFINED BENEFIT PLANS

21ST CENTURY RETIREMENT PLANNING

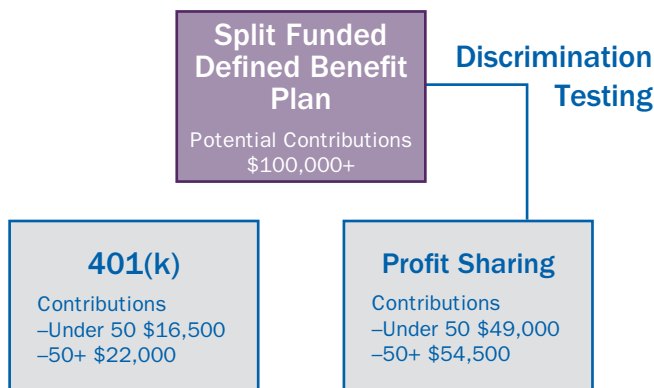


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Traditionally, companies chose between implementing either a Defined Contribution Plan, such as a 401(k)/profit sharing plan, or a Defined Benefit Plan. Each type of plan has its benefits and limitations. This summary describes the benefits and features of Split Funded Defined Benefit Plans and the opportunity that current tax law provisions present.

A Split Funded Defined Benefit Plan is a tax-qualified retirement plan established by a Company, Partnership, or Sole Proprietor. It is funded with a combination of whole life insurance and other assets (stocks, bonds, mutual funds, CDs, etc.). Participants earn retirement benefits as they complete years of service while a participant. The life insurance provides needed family protection should the participant die prior to retirement. Contributions to the Defined Benefit Plan trust provide significant income tax deductions to the business owner or sole proprietor.

A Split Funded Defined Benefit Plan can be added on top of an existing 401(k) and profit sharing plan specifically to address the needs of high income business owners or partners.



Recent Changes

The Pension Protection Act of 2006 allows employers to combine a 401(k)/profit sharing plan with a defined benefit plan. Doing so allows the business more control over the overall costs of offering retirement benefits since the plan can be tailored to meet the business' chief objectives. The rule changes fostered the resurgence of qualified retirement plans, especially for partners/owners looking for larger tax deductions and potential protection of assets in the event of bankruptcy or lawsuits.

Optimal retirement plan features typically include the following:

- The ability to make larger tax deductible contributions
- The containment of employee costs
- The flexibility in investment and product choices
- The ability for the Company/Partnership to determine individual or partner contribution targets
- The protection of Plan Assets under federal guidelines
- The ability to address planning needs on a pre-tax basis (family, estate, etc.)
- The ability to continue tax deferral and potential asset protection should a partner/shareholder retire or leave
- Portability
- Business continuation options

The plan can deliver these benefits while meeting applicable rules and regulations.

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Sample Plan	
A 55 year-old consultant with a salary of \$245,000 and \$650,000 of total earned income, no employees, wishes to make a maximum contribution to a qualified retirement plan	
Split Funded Defined Benefit Plan:	\$225,000
401(k) Salary Deferral:	\$22,000
6% Profit Sharing Plan	\$14,700
Total	\$261,700

The above is only one possible design.

Since Split Funded Defined Benefit Plan contributions are required, and must generally be made every year, caution should be exercised in designing the plan to be affordable, and consistent with anticipated earnings and the business' ongoing cash flow. Underfunded or overfunded plans may be subject to penalties or restrictions.

Motivation

- A majority of partner/shareholders have requested a plan to set aside additional pre-tax savings.
- From a partner/shareholder recruiting perspective, it is important to offer a plan that is competitive with the pre-tax opportunity and potential for asset protection available at other firms.
- Owners/Partners earning significant income cannot save as much as they may desire for retirement on a pre-tax basis due to limitations under a 401(k)/profit sharing/match structure.

Plan Design

- The final plan design may consist of a “stand alone” Split Funded Defined Benefit Plan or a combination of 401(k), profit sharing, and the Split Funded Defined Benefit plan overlay. Every plan is custom designed based on many factors and the exact contribution amounts for each partner/shareholder are subject to an actuary's testing.
- The plan should be designed to be permanent but could be reevaluated if there are significant business changes in the future and the plan poses financial hardship to the business.

IRS Determination Letter

The final plan design will be submitted to the IRS for a determination letter.

Initial Elections

- Owner/Partners will have the initial option to participate at the benefit levels determined by the plan design.

- Initial elections generally cannot be changed from year to year but changes may be considered as per approval by the actuary.
- Future partners/shareholders, including laterals, would be considered in the overall plan design subject to review by an actuary.

Advantages of Participation

Contributions to the plan would be made on a pre-tax basis and may be in addition to any current 401(k) and profit sharing plan contributions. This decreases the annual tax liability by the partner/shareholder in the year contributed.

Investment Selection

- Investments in a Split Funded Defined Benefit Plan are “pooled” with no investment direction by the individual plan participants.
- Split Funded Defined Benefit Plan assets may be invested in a wide range of investment options such as stocks, bonds, cash, mutual funds and cash value life insurance – typically whole life insurance.
- Gains in investments may require a lower contribution in requirement in future years whereas investment losses may require a higher contribution requirement.
- Investments in the 401(k)/profit sharing plan may be self-directed and managed as per individual risk tolerance.

Plan Administration

An actuarial firm would handle the plan administration working in concert with your financial advisor. Participants would receive annual statements from the actuary reflecting their portion of the plan. The annual statements would include last year's account balance, the newly added deposit, interest at a plan-specified rate, and the current balance.

Death of Participant

Upon the death of the participant the life insurance policy death benefit is typically paid to the Split Funded Defined Benefit Plan. The plan must then pass along this life insurance death benefit to the participant's named beneficiaries. A portion of this benefit is passed income tax free.* The life insurance death benefit may also be accompanied by a lump-sum retirement income benefit or an income stream.

Options at Retirement

As is typical with any defined benefit plan, one of the options is to offer the employee either a single-life or joint-life annuity payment. The plan may also offer a lump-sum distribution which the employee may elect to roll over to an IRA. There are several options to consider regarding the life insurance policy. If the employee no longer desires the death benefit coverage, the plan could

surrender the policy for its cash surrender value and use the proceeds to help fund the retirement income benefit. If the employee desires to continue the life insurance coverage, the policy would need to be removed from the plan by either a taxable distribution or a purchase for fair market value. Under no circumstances may the life insurance policy be rolled over into an IRA (although a rollover into a profit sharing plan is acceptable). If the employee wanted to transfer the retirement plan assets to an IRA, the life insurance policy would either need to be surrendered or removed prior to the rollover.

Who are the Prospects

- 1) Do you have high-income earning business owner clients who consistently complain about their tax liability each year? With income tax rates most likely increasing, you need to be able to respond to these concerns now more than ever before.
- 2) Do you have business owner clients who are frustrated with the contribution limits of their defined contribution plan (e.g. profit sharing/401(k), SEP, etc.) and would like to contribute substantially more to a qualified retirement plan (\$100,000, \$150,000 or even more)?
- 3) Do you have clients who are currently contributing to their employees' defined contribution plan but are dissatisfied with the limits on contributions imposed on them?

- 4) Do you have clients receiving earned income for sitting on boards of companies (receive Board of Director fees)? Many of these clients do not need this income and would like to shield a portion from income tax.
- 5) Do you have clients who are partners with law firms or medical practices looking for increased tax deductions and potential for asset protection? Or maybe a law firm or medical practice looking for a strategy to retain and/or attract new partners?
- 6) Do you have high-income earning clients who are writers, consultants, lobbyists, or small business owners who are looking for a new financial idea?
- 7) Do you have clients looking for an innovative business succession strategy?
- 8) Do you have clients looking for increased retirement funding and a potentially tax-deductible way to fund a "buy/sell agreement?"
- 9) Maybe you have clients who have previously explored a Defined Benefit Plan but decided against it due to high employee cost and/or perceived inflexibility - new pension rules now afford more dynamic and custom plan designs - now is the time to revisit these plans with your clients.

All of the above provide a conversation starting point with your clients.

Call your Wealth Structuring Insurance Specialist at 1-877-472-6544 or the PensionQuote Team at 1-800-717-4723 to discuss further.

*For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j). Per Treas. Reg. Sec. 1.72-16(c)(2)(iv), if the participant included the cost of life insurance protection as taxable income, a portion of the death benefit proceeds (that amount above the cash value) is treated as excludable benefits under IRC Sec. 101(a)(1).

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