Buying Life Insurance in Your Qualified Plan

If you're a business owner and you need life insurance, purchasing it inside of your qualified retirement plan is a great way to pay for the premiums. Contributions into the plan are tax-deductible and then some of these contributions and possibly other plan assets, depending upon the type of plan, may be used for the life insurance. Qualified retirement plans may allow for the purchase of life insurance, but within certain limits known as the "incidental benefit rules." Life insurance must be incidental to the retirement benefits provided under the plan. If you are interested in purchasing life insurance within your plan, you need to be aware of the rules.

For a defined contribution plan such as a Profit Sharing/401(k) plan or a Money Purchase Plan, life insurance is considered incidental under the following limits:

- Up to 49.9 % of cumulative contributions may be used to purchase whole life (WL) insurance.
- No more than 25% of cumulative contributions if Term, Universal Life (UL), or Variable Universal Life (VUL) insurance, is purchased
- No more than 25% of cumulative contributions if any combination of WL and Term, UL, or VUL is purchased. Terms riders count toward this limit, so be careful when using term riders.

Note that the plan document must provide for the purchase of life insurance in order to pursue this strategy. The plan documents for Profit Sharing Plans (all 401(k) plans are Profit Sharing Plans with a Cash or Deferred Arrangement), should also contain provisions to apply the "seasoned money" rules. These rules apply *only* to Profit Sharing Plans. The "seasoned money" rules are as follows:

- 100% of money rolled over from an Individual Retirement Account (IRA) or other qualified retirement plan, into the plan may be used to purchase life insurance.
- 100% of Employer contributions, including forfeitures and earnings, that have accumulated for more than two years may be used to purchase life insurance. This rule does not apply to deferrals and safe harbor contributions.
- 100% of the participant's account balance, if the participant has been a participant for 5 or more years may be used to purchase life insurance.

Also, the purchase of life insurance on the life of anyone in whom the plan participant has an insurable interest, even if that person is not a participant in the plan (i.e. spouse, child, business partner), can be done in a Profit Sharing Plan which permits the purchase of life insurance. To re-emphasize, the plan document must specifically contain provisions allowing for the purchase of life insurance and for this use of "seasoned money," otherwise it can't be done. Note, however, that plan documents that do not currently have the appropriate provisions may be amended to include these provisions.

The incidental benefit rules for defined benefit plans are different as there are two methods for determining the amount of death benefit that may be provided under the plan. One method is benefits-based, where the death benefit cannot exceed a certain percentage of the retirement benefit (percent-of-benefit method), and the other is contributions-based, where the contributions allocated toward life insurance premiums cannot exceed a certain percentage of the plan contribution (percent-of-contribution method).

Percent-of-Benefit Method:

- Life insurance is considered incidental if the face amount of the insurance policy(ies) provided under the plan does not exceed 100 times the participant's projected monthly retirement benefit,

Retirement Planning

Example:

Projected monthly benefit at normal retirement age = $10,000

Maximum Death Benefit: 100 X $10,000 = $1,000,000

Percent-of-Contribution Method:

- The amount of whole life insurance is considered incidental if:

  (1) less than 50 percent of the employer contribution credited to each participant's account is used to purchase ordinary life insurance (i.e., whole life insurance) on the participant's life, even if the total death benefit consists of both the face amount of the policies and the amount credited to the participant's account at the time of death, or

  (2) such death benefits would be considered incidental and the total death benefit before normal retirement date is equal to the greater of:

    (a) the proceeds of ordinary life insurance policies providing a death benefit of 100 times the anticipated monthly normal retirement benefit, or

    (b) the sum of (i) the reserve under the ordinary life insurance policies, plus (ii) the participant's account in the auxiliary fund.

  This is also referred to as the Theoretical Reserve Rule pursuant to the IRS's Revenue Ruling 74-307. This amount is actuarially determined and the premium *can be no more than* two-thirds of the level cost of providing the same monthly retirement benefit under the plan without life insurance.*

Just like the rules pertaining to defined contribution plan documents, defined benefit plan documents must allow for the purchase of life insurance pursuant to one of the methods cited above.

IMPORTANT: If any of the incidental limits cited are exceeded, the result could be plan disqualification and loss of tax deductions.

Please consult with your Guardian Financial Representative if you have any questions concerning this document.

Lanny D. Levin, CLU, ChFC
LANNY D. LEVIN AGENCY, Inc.
1751 Lake Cook Road suite 350
Deerfield, IL 60015
(847) 597-2444
lanny_levin@levinagency.com

*The limits pertain to Whole Life policies. The limits are reduced for Term or Universal Life policies.

GEAR # 2012-6678 Expiration: 12/31/2015