

## THE 412(E)(3) FULLY INSURED DEFINED-BENEFIT PLAN

### RETIREMENT PLANNING ADVANTAGES FOR THE WELL-ESTABLISHED BUSINESS OWNER



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*Imagine a 55-year-old dentist with a flourishing practice who is planning to retire in 10 years. Despite his success, he has encountered a number of financial obligations through the years which caused him to put off retirement planning.*

*Unfortunately for small business owners, defined contribution plans, such as a 401(k), have limits on how much you can contribute, so they may not provide enough retirement income. In addition, the value of assets in certain plans can be highly volatile, since these types of plans may be directly affected by stock market fluctuations.*

*So how can our dentist reach his retirement goals?*

*Read on to find out.*

#### **Secure Guaranteed Retirement Income**

If you are the owner of a small business or are self-employed and looking for guaranteed retirement income, a 412(e)(3) DB plan is worth considering. This type of plan is a *defined benefit* plan, which, unlike defined contribution plans, promises a specified benefit upon retirement. Under a 412(e)(3) plan, each participant is provided with a guaranteed, pre-determined benefit amount that is fully insured. The reason they are fully insured is because this type of account relies on the purchase of fixed annuity or life insurance/annuity contracts rather than by investing in the stock market. For this reason, a fully insured 412(e)(3) DB plan can provide substantial retirement benefits without market risk.

The benefit to you: more confidence in your ability to retire, because your retirement savings are both guaranteed and protected from market volatility.

## Maximum Savings and Maximum Tax Deductions

Fully insured, defined-benefit plans are unique in the retirement planning arena because they have a higher tax-deduction limit than most other plans. In addition, plan contributions may be greater than those made to traditional defined-benefit plans because they are funded using fixed-annuity or life insurance products. Business owners and professionals are able to set aside large amounts of money each year, while taking large tax deductions for doing so—and enjoy the fully guaranteed retirement benefits the plan provides.

The benefit to you: the ability to set more money aside for retirement while simultaneously saving in taxes. The technical term for this is a “win-win.”

## Less Complication

Another attractive feature of 412(e)(3) plans is that they avoid the complications commonly associated with traditional defined-benefit plans. For example:

- no certificate from an enrolled actuary is needed
- quarterly contributions are not required
- there is no full-funding limitation that might limit contributions
- administrative costs are generally lower

412(e)(3)s can also protect the assets in your plan from lawsuits and creditors.

The benefit to you: if you are self-employed in any way, the last thing you need is more complications in your life. 412(e)(3) plans are handy because they make setting up a retirement plan simpler instead of more complex.

## Exempt from Funding Requirements

These plans are exempt from the IRC Section 41 funding requirements because the burden of providing the benefit is shifted from the *employer* to an *insurance company*. They are referred to as a “fully insured” plan because the benefits are guaranteed by an insurance company (subject to its claims-paying capacity).

## Dividends May Offset Contributions

While contributions (based on guaranteed interest and mortality assumptions) to a fully-insured plan generally remain high, they can decrease over time if the assets contributed toward the plan earn dividends or interest over and above the guaranteed levels. In this situation, these “extra” earnings must be used to offset contributions.

## Are You a Good Candidate?

As you can see, 412(e)(3) plans are a powerful way to save for retirement. But they're not right for everybody. The best candidates for this type of plan are small companies or self-employed individuals that:

- ❖ Have less than five employees
- ❖ Have high, stable profits
- ❖ Have an older owner with younger employees
- ❖ Have a substantial tax liability and want a potentially significant tax deduction
- ❖ Have the ability to pay ongoing contributions
- ❖ Are willing to make a five- to 10-year contribution commitment

Upon retirement, the participant receives fully guaranteed benefits in the form of a stated monthly pension, or, as an alternative, as a guaranteed lump sum (which you can then roll into an IRA if desired.) Of course, it's important to remember that the retirement payout you receive is subject to the same IRS limits as all other defined-benefit retirement plans.

So ask yourself this question: would you value a fully-insured source of retirement savings that is both simple to set up and easy on your tax bill? If the answer is yes, then it's worth your while to learn more about how 412(e)(3) plans work and whether they are right for you. To receive more information, simply give me a call at 610-478-9500.

Of course, there are other types of retirement plans out there, each with their own advantages and disadvantages. If you would like more information on 401(k)s, SEP IRAs, Simple IRAs, or profit-sharing plans, call the number above or e-mail me at paul@paulfair.com.

Whatever direction you choose, don't be like the dentist in the story above. Don't just *hope* you can retire. *Know* you can.

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