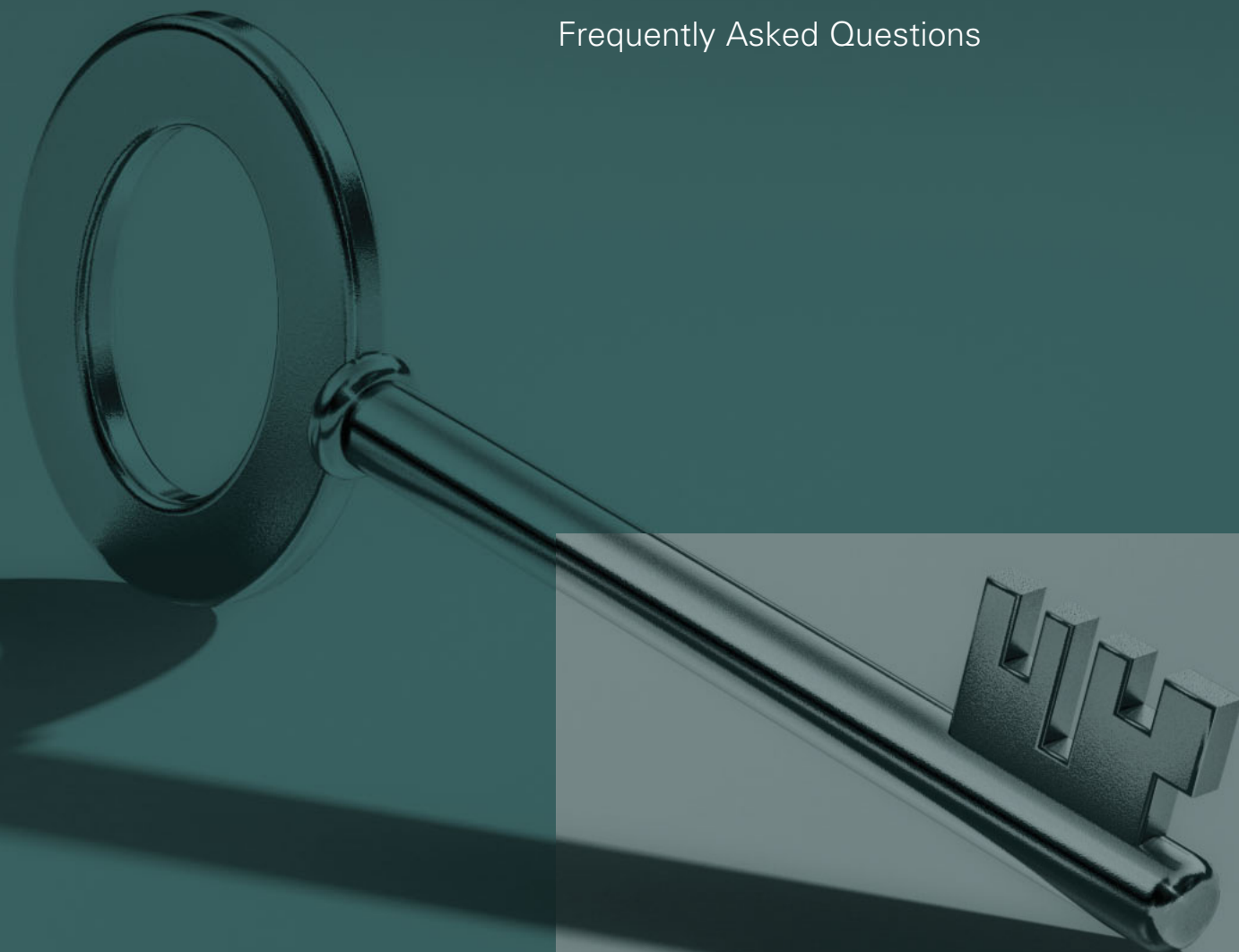




IRC Section 412(i) Plan

Frequently Asked Questions



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Transamerica Occidental Life Insurance Company

Q. What is an Internal Revenue Code (IRC) Section 412(i) plan?

A. An IRC Section 412(i) plan is a qualified defined benefit pension plan, funded exclusively with annuity contracts or a combination of annuities and whole life insurance. They are also known as “Fully Insured Defined Benefit Plans.” Like all qualified retirement plans, employer contributions are generally tax-deductible for the employer. Plan values grow tax-deferred, and distributions to plan participants or their beneficiaries are subject to income tax. The plan must meet the typical coverage and nondiscrimination rules imposed on all qualified retirement plans.

Q. How do IRC Section 412(i) plans differ from traditional defined benefit retirement plans?

A. IRC Section 412(i) plans rely on the guarantees of insurance company contracts to fund the benefits promised at retirement. This will typically create larger tax-deductible contributions for the plan sponsor—the employer—in the early stages of the plan, as compared to later years due to excess interest earning in the plan, when plan participants get closer to retirement. Since the plan benefits are funded with guaranteed Transamerica Occidental Life Insurance Company policies, an actuary is not needed for annual valuation or certification.

Q. What makes Transamerica’s approach viable now that the IRS has issued final regulations and other guidance that address the valuation of life insurance policies?

A. The IRS and Treasury issued final regulations and Rev. Proc. 2005–25 in 2005 to address the valuation of life insurance for qualified plan purposes, including IRC Section 412(i) plans. The verdict? Transamerica's approach to 412(i) plans is a safe option.

The IRS focused on aggressive 412(i) plan policy designs that utilize low policy valuation for income tax purposes when the life insurance policies were distributed or purchased from the plan. These plans may not deliver the promised benefits due to this guidance by the IRS. In comparison, Transamerica’s 412(i) approach does not rely on unrealistically low policy valuation and is intended to help clients reach their retirement goals either through a guaranteed monthly income at retirement or a lump-sum transfer to a profit-sharing plan or an IRA.

Q. Why is there so much interest now?

A. Congress has given new incentives to employers to provide for their employees’ retirement. These include:

- **Increased plan benefits**—A defined benefit plan may now provide a benefit up to \$175,000 annually, an increase from \$140,000 just a few years ago. Full benefits may be paid as young as age 62, whereas previously, full benefits were tied to the participant’s normal retirement age as defined by Social Security (age 67 for those born in 1960 and after).
- **No more plan aggregation**—This Code section had previously put a limit on the benefits a plan participant could accrue under a defined benefit plan if he or she is currently, or has ever been, a participant of a defined contribution plan sponsored by the same employer. Under current regulations, prior participation in such a plan does not affect a participant’s benefit under a 412(i) plan.
- **No more family aggregation**—Under prior law, a married couple’s benefit was aggregated for benefit limitation purposes as if they were one plan participant rather than two separate individuals. With the elimination of this rule, each spouse is treated as a separate plan participant and is able to accrue a benefit based on his or her individual compensation.

Q. What other factors have contributed to the popularity of IRC Section 412(i) plans?

A. ■ **Aging U.S. population**—The American Association of Retired Persons (AARP) notes that with over 76 million U.S. residents age 50-plus today, the 50-plus market is clearly a powerful force.* Many of these Americans are small business owners and professionals who have put off saving for retirement so they could invest in their businesses, send their children to college, and provide for their families.

*“*Staying Ahead of the Curve 2003: AARP Working in Retirement Study*” (September 2003).

For those with a stable business, now is the time to fund a retirement plan, and the annual contribution limit of the lesser of \$44,000 (\$49,000 for those individuals age 50 or older) or 100% of includible compensation placed in a profit-sharing plan may not allow them to meet their retirement planning goals. IRC Section 412(i) will generally allow a larger plan contribution in initial plan years than any other type of qualified plan, due to the amount needed to provide the income stream based on annuity and insurance company contract guarantees.

- **Volatile stock market**—The roller coaster ride of recent years—and subsequent losses—have made many people appreciate the value of guarantees in their retirement planning. By using an IRC Section 412(i) plan, employers will not be subject to market fluctuations affecting their plan contributions. Plan participants can rest assured that their funds for retirement will not be affected by stock market volatility.
- **Creditor protection**—Many professionals, especially doctors, accountants, engineers, and architects, are looking for ways to protect their assets from creditors and potential lawsuits. Money held inside an IRC Section 412(i) plan, like most qualified plans, is generally protected from creditors.

Q. Who is the best prospect for an IRC Section 412(i) plan?

A. Sole proprietors, partnerships, corporations, and any business entity. However, these plans work best for small, stable, closely held companies with few employees seeking to maximize tax deductions and provide a substantial retirement benefit.

Q. Who pays for an IRC Section 412(i) plan?

A. The sponsoring business entity covers the setup and annual administration fees and makes the contributions to the plan.

Q. Are the contributions tax-deductible?

A. Yes. The employer's contributions are generally tax-deductible, and the employees pay income tax when distributions are made.

Q. Is there any cost to employees?

A. If the plan is funded with life insurance policies in addition to annuity contracts, the participants must recognize the "current economic benefit" provided by the life insurance policy. This was commonly referred to as the PS-58 cost, although it is now usually based on new IRS Table 2001—unless the life insurance carrier has qualifying annual renewable term rates available (Transamerica Occidental Life Insurance Company does offer qualifying annual renewable term rates). The cost will vary for each participant based upon age and amount of life insurance coverage.

Q. What is the advantage of using contract guarantees to determine the funding?

A. Typically, the contract guarantees are much lower than the interest rate used to calculate funding for a traditional defined benefit plan. This results in higher contributions and deductions in the early years than a traditional defined benefit plan.

Q. Can an employee or an owner participate in a 401(k) plan as well as an IRC Section 412(i) plan?

A. Yes, but where both exist there are aggregate limits on how much, and if, the employer can take income tax deductions for contributions to both plans. If contributions are deemed to be "nondeductible contributions," then a 10% excise penalty may apply.

Now is the right time to use the guaranteed benefits offered by a 412(i) plan funded with Transamerica Occidental Life insurance and annuity products. To see if you may have a prospect for a 412(i) plan, contact your local Transamerica representative.

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