412(i) Plans More Appealing in Volatile Markets

A 412(i) may provide a retirement saving alternative for small business owners and professionals.

During volatile markets, opening your 401(k) statement can be disheartening. Business owners and professionals may find an appealing option in a 412(i) plan, a defined benefit pension plan funded by life insurance and/or fixed annuities, based on the owner or executive's need and insurability. In exchange for a typically lower rate of return than a 401(k) plan, participants in a 412(i) plan can make larger annual contributions, receive a guaranteed retirement benefit and reduce their taxable income. Because they use insurance products, 412(i) plans are exempt from minimum funding requirements that apply to traditional pension plans.

412(i) plans generally work best for businesses with 10 or fewer employees, including doctors, consultants, real estate agents and business owners. Because the annual contribution limits are substantially higher than for other types of qualified plans, business owners who have failed to save sufficiently for retirement may find value in a 412(i). It may also be appropriate for someone with a substantial tax liability who wants the potential for a significant income tax deduction each year.

In a 412(i), the employer makes contributions, which may be tax deductible up to 100 percent, to the plan. The contributions are used to purchase and pay ongoing premiums on an insurance contract covering an employee. The insurance company guarantees a fixed retirement benefit based on the policy's cash value. The amount of the benefit, which is calculated using a formula stated in the plan, is based on each employee's compensation, age, length of service or a combination of those factors.

Contributions come from pre-tax dollars, thereby reducing the participant's taxable income. The insurance can potentially provide a death benefit to beneficiaries if the participant dies before retiring. Once created, an employer must make contributions to sustain the minimum-funding requirements, including annual actuarial calculations. An employer must ensure that the company will be able to afford contributions in leaner years.

The IRS has kept a watchful eye on 412(i) plans because of past abuses. Some taxpayers have attempted to use the plans to tax excessive deductions. For this reason, a tax attorney with experience in 412(i) plans should be consulted to ensure full compliance with tax law.

In specific circumstances, a 412(i) plan can provide an opportunity for a small business owner or professional who has delayed retirement saving to catch up with larger contributions than other plans allow, while realizing a significant tax benefit. During volatile markets, some owners may find the guarantees provided by the insurance products more attractive than the larger returns of other investments.

The 412(i) defined benefit pension plan is a tax-qualified retirement plan that must comply with the Employee Retirement Income Security Act (ERISA), the Internal Revenue Code and other applicable law.

Sydney Riccio is a Coto resident, a financial advisor with Cooper McManus, a Representative with Securities America, a registered Broker/Dealer, member FINRA/SIPC, and a certified college funding advisor. For more information, contact ***(800) 516-5333 x 121 or www.SydneyRiccio.com****. CA Insurance License 0E01624. Advisory services offered through Cooper McManus, Inc., a SEC Registered Investment Advisory firm. Securities offered through Securities America, Inc. Cooper McManus and Securities America are unaffiliated. Article by Securities America, submitted by Sydney Riccio.*