LEVERAGING LIFE INSURANCE

In Defined Benefit Pension Plans

Defined Benefit Pension Plans can provide business owners who are older with possible solutions to burdensome taxes. This type of pension plan helps retain more of what is earned by the business owner and helps reduce personal income tax liability. This solution, which helps a business owner to defer more income and reduce overall personal tax liability, is even more attractive to business owners operating as an S corporation, an LLC, or other pass-through tax entity where there are few deferral opportunities.

Defined Benefit Pension Plans that have a life insurance component providing a pre-retirement death benefit can allow deductible annual contributions of $100,000, $200,000, or more for qualified professionals, small business owners, and the self-employed.

Not everyone is right for a defined benefit plan. Typically, those that benefit the most are those who are ages 40-45 or older who typically generate income that puts them in a high tax bracket in one of the following ways:

- Owns a business with few, if any, employees
- A self-employed independent contractor
- A business owner who already has a "safe harbor" 401(k)/profit sharing plan with multiple employees, most of whom are younger than the business owner and who earn considerably less salary

The business owner should generally want to contribute more than the current $53,000 dollar limit of a defined contribution plan (such as a 401(k) plan). In addition, there should be the expectation that the owner will be able to make the defined benefit contributions for at least 3 or more years.

By adding life insurance in the pension plan the plan participant gets:

- A self-completion feature in the event of a premature death
- A larger tax-deductible contribution than is available if the same plan is funded without life insurance (This becomes even more attractive if the insured is ratable). The premiums become deductible, not as life insurance, but as part of the pension plan contribution
- At a point in time (usually after the life insurance premiums have ended based on current earnings), the trustee of the plan will give each participant (or their irrevocable life insurance trust set up as a grantor trust) the option to purchase their policy from the plan for its fair market value. The transfer of ownership potentially allows:
    - *An income tax-free cash flow through the use of withdrawals and loans to provide supplemental retirement income*
    - *The ability to pass on substantial life insurance death benefits to heirs*
    - *The ability for an irrevocable life insurance trust to buy or loan assets to pay estate taxes*

Pinnacle has the ability to obtain proposals based on the actual employee makeup and desired contribution for the business owner. We can provide the required fact finder requesting full employee census information, details about any existing 401(k)/ profit sharing plans, and information on any other businesses owned by the same owner(s).

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EXECUTIVE BENEFITS

LEVERAGING LIFE INSURANCE

Continued

2014 Case Studies: Defined Benefit Plans

OWNER ONLY BUSINESS

Case Facts: Independent consultant, age 51, consistent income over $500,000

Goal: Reduce taxes by making a maximum Contribution to qualified plans, retire at age 62

Remedy: Fund Defined Benefit (DB) plan and a Solo (401(k)/Profit Sharing Plan)

The Results

Annual Contribution to Plans	$215,308
Estimated Tax Savings @ 44% *(combined Federal and CA state rates)*	$105,501
Estimated accumulation at retirement	$3,228,497
Life Insurance Face Amount	$1,395,570
Life Insurance Premium	$79,227

OWNER + SPOUSE BUSINESS

Case Facts: Professional athlete with outside income from endorsements

Goal: Maximum contributions and tax deductions

Remedy: Maximum fund Defined Benefit (DB) plan and EZ-K (401(k)Plan)

The Results

Annual Contribution to Plans	$229,995
Estimated Tax Savings @ 44% *(top Federal rate(2012)—no TX state rate)*	$91,998
Life Insurance Face Amount (2 Policies)	$2,043,132
Life Insurance Premium	$78,478

LARGER COMPANY WITH EMPLOYEES & EXISTING 401(K) PLAN

Case Facts: LLC with 13 total employees & existing 401(k)/Profit Sharing Plan.

Goal: Two owners seeking increased tax deductions without increasing contributions for employees. Employees are younger than mature owners.

Remedy: Fund Cross-Tested Carve-Out DB plan on top of existing 401(k)/Profit Sharing Plan

The Results

Annual Contribution to Plans	$680,669
Estimated Tax Savings @ 41% *(combined Federal rate and NC state rate)*	$319,914
Two owners share of contributions	91.7%
Total Life Insurance Premium	$208,559

COMBO PLAN SALE

Case Facts: Family owned and operated "C" Corporation with 7 employees—5 of whom are family members

Goal: Reduce taxes and provide benefits for family members—particularly mature members

Remedy: Fund a Defined Benefit Plan and a stand-alone 401(k) Profit Sharing Plan

The Results

Deductible Contributions to Both Plans	$457,348
Estimated Tax Savings @ 44% *(combined Federal rate and NJ state rate)*	$224,101
Family's share of contributions	97.8%
Total Life Insurance Premium	$164,926

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