

**Voluntary Employee
Beneficiary Associations
(VEBAs)
And
419 Plans**



Introduction



- For discussion purposes, we will use the term VEBA and 419 Plan interchangeably.
- There are slight differences, but they are not important for a cursory review of this topic.
- What is a VEBA/419 plan?
- It is an “employee benefit plan” which provide TAX-FAVORABLE death benefits and/or living medical benefits for employees.

Who Should Have A VEBA/419 Plan?



- Profitable businesses who wish to reduce their income taxes
- Firms which have maximized their retirement plan contributions
- Business who's owners want to fund for their post retirement medical expenses now in a tax deductible manner where the benefit is income tax free.
- Firms whose owners have estate tax problems and who wish to reduce or eliminate inheritance taxes
- Businesses who wish to protect their assets from creditors
- **A VEBA works best in small employers with less than 3-5 employees per owner.**

Always Keep in Mind



- **VEBAs and other Welfare Benefit Plans are NOT deferred compensation plans.**
- The plans provide for death benefit and living medical benefits.

“WISH LIST” FOR ACCUMULATING WEALTH

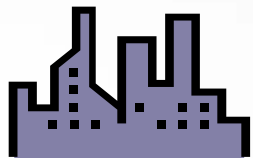
- Save money on tax-deductible basis
- Allow assets to accumulate tax-free
- Available to any type of business
- Protected from creditors
- Pass to heirs estate-tax free
- Limited vesting for employees
- Flexible contributions - no minimum commitment
- May make large contributions in good years
- Funds are securely held - safety of investment
- **VEBAs/419 Plan can help accomplish the above mentioned goals.**



How does a VEBA/419 Plan work?



- An employer sets up a plan (trust).
- The employer makes tax deductible contributions to the plan for the employees' benefits (typically with a long vesting schedule).
- If the plan is a death benefit plan, if an employee dies when the policy is in the plan, the DB will pass income AND estate tax free to their heirs.
- The plan can pay income tax free to employees who have post-retirement medical costs that need to be paid.

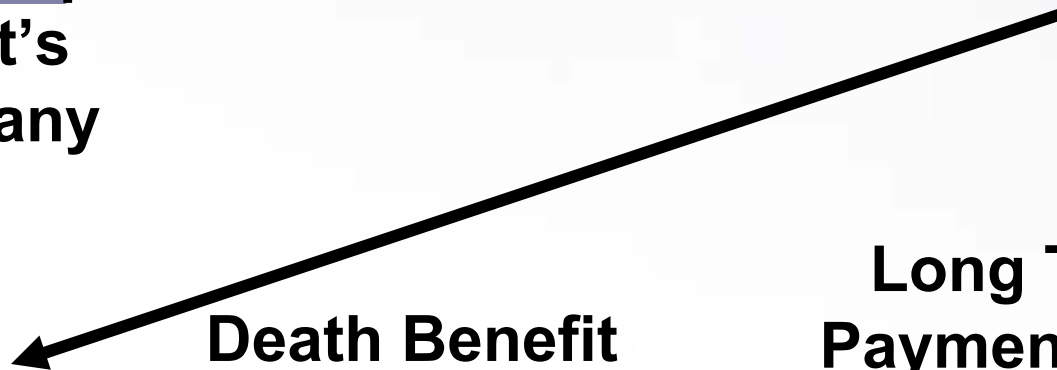


**Client's
Company**

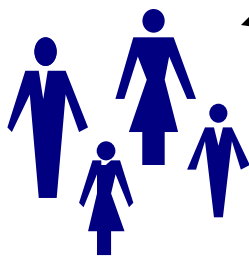
**Company pays tax
deductible contributions
to the VEBA**



VEBA Trust



**Death Benefit
Income and
Estate Tax Free**



**Designated
Beneficiary**

**Long Term Care
Payments (tax free)**



Type of Plan



- There are three types of VEBAs/419 plans:
 - single employer plans (419E plans),
 - multiple employer plans where a group of employers share the costs of establishing and maintaining a plan with similar benefits for each employer group, and,
 - ten-or-more employer plans which seek to comply with 419A(f)(6).

Which kind to implement?



- To be brief, it is preferable to implement a plan through the use of a single employer plan.
- Why?
- Because of negative regulations issued by congress on multiple employer plans.

Where is the money in a VEBA trust invested and why?



- In most plans the money is invested in cash value life insurance.
- Life insurance is used to fund the death benefit of the client.
- Why “Cash Value” life insurance?
 - The cash value can be used to pay for post retirement medical benefits.



Death Benefit



- Premiums are paid with pre-tax dollars
- Multiple of compensation formula favors key employees
- May select term or permanent insurance
- Coverage may continue after retirement
- Death proceeds are **tax-free** to beneficiary and can avoid estate taxes upon distribution if an irrevocable beneficiary designation is made.
- May be used for estate planning or buy-sell funding

Remember: Life insurance in excess of \$50,000 creates current taxable income to insured.



Retiree Medical Benefit



- The Plan may provide a fund for the payment of medical expenses tax-free after the participant's retirement. Medical expenses are broadly defined under IRC Section 213(d), and include such items as out-of-pocket expenses, long-term care premiums, Medicare Supplement coverages, etc.



Health Reimbursement Benefit



- In addition to medical benefits after retirement, the retiree medical account may be used prior to retirement for payment or reimbursement of medical expenses which are not covered by insurance.



ASSETS SAFE FROM CREDITORS



- Wouldn't it be a shame to build a large nest egg and lose it overnight because of an accident, a lawsuit or a business setback? As an ERISA-qualified plan, your assets held in the VEBA are fully protected from creditors.
- VEBAs are not “asset protection plans”.



Doing it right



- It is vitally important that clients implement VEBAs and 419 Plans in the correct manner.
- Why?
- Code section 6707A provides for a \$100,000 penalty for an individual and a \$200,000 penalty for all other taxpayers when the client does not disclose involvement with a “listed” tax transaction.

Plans to stay away from



- Any plan where the employee owns the life insurance policy and irrevocably assigns the death benefit to the trust.
- Carve-out plans where you are told you do not have to cover any employees.
- Any other plan that does not meet your smell test.
- If you have been or are being pitched one of these plans and wonder if it is the right one, please contact our office for assistance.
- Any kind of Union plan (419A(f)5

Should you be using a VEBA/419 Plan?



- Yes IF
 - You have small business and are looking for flexible and sizable deductions in a benefit plan.
 - You are interested in purchasing a death benefit with tax deductible dollars.
 - You would like death benefits to have the opportunity to pass income and estate tax free to the beneficiaries.
 - You would like to fund in a tax deductible manner for living medical benefits (which are not taxable when received).

Conclusion



- By learning the proper way to use VEBAs/419 plans, you will be able to determine if this unique tool is a good fit for you and your company.
- For assistance on this topic, please feel free to contact our office.