What’s New With Section 79 Plans

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What is a “Section 79” Plan?

- A Section 79 Plan is an employee (EE) benefit plan that falls under the “group term life insurance” section of the IRC.
- There is really no such thing as a Section 79 Plan in the code.
- The term Section 79 Plan comes from how Section 79 in the IRC is used to benefit business **owners** through the purchase of individually owned **cash value life insurance policies**.

Design

- The plans are designed to fund for **five years** at a level amount.
- The deduction is 100% to the Corporation, but the EEs may have to recapture, as income, a portion of the premium.
- The cash value policies used in the plan are designed to be **terrible cash accumulators** in years 1-5 so the **recapture of income will be lower**.

$50,000 in Term Life

- An employer (ER) may provide employees with up to $50,000 face amount of group term life insurance protection each year **without cost** to the employee.
- To the extent that the $50,000 face amount is exceeded, the cost **must be included in the gross income of the employee** and is reportable on the EE’s W-2 as additional compensation.

Cash value life insurance

- The language of Section 79 alludes to "**<u>permanent</u>**" benefits.
- This has been interpreted by most to mean that you can buy a **<u>permanent policy</u>** through the plan.
  - Whole life
  - Universal life (including EIUL)
  - Variable life
- By the code itself, the policies CAN NOT be owned by the corp. and the corp. CAN NOT be the beneficiary.

History

- Section 79 Plans have been around for years.
- Prior to the Rev. Rulings/Procs, the IRS put out on how to value policies being removed from qualified plans, the deduction for a business owner to purchase a policy through the plan **<u>used to be</u>** **<u>70-80%</u>**.
- After the IRS guidance, the plans went to about 20% deductible.
- With better or worse (depending on your point of view) policy design, **<u>now</u>** the plans are seen as **<u>35--45%</u>** deductible.

Discriminatory Benefits

- 1. The plan cannot discriminate in favor of “key” EEs.
- 2. Discrimination rules are related to the amount of life insurance on each participant.
- 3. Discrimination rules are determined by a formula.
- 4. EEs may purchase additional benefits.
- 5. **EEs may elect out of the plan without affecting the plan’s discrimination status.**

How are plans really sold?

- You **sell the plan** to a business owner.
- Then you do an **enrollment meeting**.
- At the meeting you tell EEs attending that the ER is going to buy life insurance on all eligible EEs.
- What a great day right?
- Then it is explained that if they take the full benefit, they will have **“phantom” income** and won’t be able to buy beer and cigarettes.
- Then the EEs are handed an **opt out waiver** where they choose only non-taxable 50k of term life insurance.
- This is **NOT** something that should be in a brochure*.

Typical Small Business Client

- Age 35-55, married 1-3 children.
- 0-25 employees.
- 1-3 owners.
- Making $150,000+ a year.
- Has UL or WL for:
  - Death benefit
  - Retirement vehicle
- Policy premium is paid for with post-tax dollars.

Who can adopt a Section 79 Plan*?

- C Corporation*
- Create a management or other company (a real one) and have that be a C-Corp.
- This is not done to get around discrimination testing.
- Partnership but cannot include any partners
- Sub S but cannot include any 2% or greater shareholders
- No sole proprietors

Fewer than 10 employees

- **All** EEs must be covered
- The following EEs may be excluded:
  - EEs who work part-time, meaning **20 hours** or less per week or five months or less in any calendar year.
  - EEs who are in a waiting period which may extend up to six months before becoming eligible for company benefits.
  - EEs who continue to work after they attain age 65.
  - Those that are “uninsurable.”

Uninsurable issue

- Evidence of insurability is limited to a medical questionnaire (**no medical examination**) completed by the EE.
- Because no medical exam can be taken by the insurance carrier in a group with less than 10 lives, insurance carriers will commonly place a limit as to the maximum face amount of insurance.
- This is the **main problem** with the “new” Section 79 plan*.

10 or more EE rules

- The plan must benefit at least 70% of all EEs, or at least 85% of all participating EEs must not be characterized as “key EEs”.
- Typically, must have at least 10 EEs covered.

Why use a Section 79 Plan?

- To allow business owners to effectively write off **35-45%** of their cash value life insurance policies.
- How?
  - When a Section 79 plan with permanent benefits is offered to the EEs, 99%+ of them will opt for the minimum $50,000 of term coverage.
  - EEs will opt out of the permanent benefits coverage. (All EEs must be offered permanent policies)
  - This will create a **legal discriminatory plan** for the owners of small businesses.
  - Owners/Key EEs will own individual cash value policies that effectively were **35-45%** deductible.

Remember the question

- How do clients typically pay for their cash value life insurance policies?
- They cut a post-tax check out of their bank account.
- Would your small business clients like to pay for that same policy and have it be **35-45%** deductible?
- YES.

Example

- **Eligible Employees**

Employee	M/F	DOB	Salary	Death Benefit
Dr. Green	M	1/1/59	$322,659	$1,774,623
EE#1	F	1/1/74	59,000	324,500
EE#2	M	1/1/69	25,000	137,500
EE#3	F	1/1/64	34,000	187,000
EE#4	M	1/1/59	17,680	97,340

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Census and Plan Benefits

Full Permanent Insurance

Employee	Death Benefit	Corp Premium	Safe Harbor EE Perm Cost	Table I
Dr. Green	$1,774,623	$100,000	$63,610	$3,194
EE#1	324,500	9,404	6,112	264
EE#2	137,500	5,526	3,591	95
EE#3	187,000	7,583	4,928	165
EE#4	97,240	5,441	3,536	86

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Full Term Insurance

Employee	Death Benefit	Corp Premium	Table I
Dr. Green	$1,774,623	$4,308	$3,194
EE#1	324,500	258	264
EE#2	137,500	165	95
EE#3	187,000	278	165
EE#4	97,240	311	86

Continued

$50,000 Term

Employee	Death Benefit	Corp Premium
Dr. Green	$50,000	$177
EE#1	50,000	81
EE#2	50,000	102
EE#3	50,000	115
EE#4	50,000	177

Continued

Sample Taxable Income Report for Dr. Green-5 Years

Employee	Table I	Perm. Benefit Safe Harbor	Total Taxable Income	Actual Tax Paid 40%
Dr. Green	$3,194	$63,610	$66,804	$26,722
Year 2	3,194	63,930	67,124	26,850
Year 3	3,194	64,350	67,544	27,081
Year 4	3,194	64,880	68,074	27,230
Year 5	3,194	65,500	68,694	27,478

Sample Contributions and Tax Free Distributions for Dr. Green Assuming 5 year Corporate Contribution of $100,000/year

Year	Annual Funding	Contribution by Corporation	Additional W2 to Dr. Green	Net Cost in 40% Bracket
1	$100,000	$100,000	$66,804	$26,722
2	100,000	100,000	67,124	26,850
3	100,000	100,000	67,544	27,018
4	100,000	100,000	68,074	27,230
5	100,000	100,000	68,694	27,478

Total Tax Paid by Dr. Green $135,296

Income Tax-Free Retirement Distribution (Age 65-84)* $91,354
Total 20 Year Tax-Free Retirement Distributions $1,827,000

*Assumes crediting rate of 4.05% (from age 45 to age 51) 9% thereafter

The “**New**” Section 79 Plan

- A “new” plan just came into the market.
- It allows for conversion in year six to an **EIUL** policy instead of a **variable**.
- This is great if you want to use a plan that by design is setup to have the policy be a **piece of garbage** the first five years in order to get a larger deduction.
  - Which is what a classic 79 Plan does.
- The **problem** with the plan,the company does not have **non-medical underwriting** of groups of less than 10 EEs.

Continued

- This is a huge issue.
- The proposed plan has a client buying a medically underwriting term life policy.
- Then the EE/owner will setup a Section 79 Plan and will "**convert**" the term policy.
- The theory being that there was no underwriting to convert the term policy.
- This is a **bunch of nonsense** in my opinion and unless the insurance company gives me a letter stating that they back this theory, I can not endorse it's use for groups of less than 10 EEs.

How about just using a “good” EIUL from the start?

- I’ve been saying this for some time.
- Why use a **piece of junk policy** the first five years and get a 30-40% deduction if you could use a a “**good**” cash accumulating policy while still getting a 20% deduction?
- It’s simple, like the incorrectly sold 412(i) plans, agents sell Section 79 on the deduction, not the outcome in retirement.

Example: New 79 EIUL

- Assume the client is a 50-year old male who takes tax-free loans for 20-years starting at age 65.

Death Benefit	1,762,454	1,762,000
Total 5yr premium	**500,000**	**470,000**
5yr tax cost (@33%)	103,950	132,502
Total 5yr cash flow	**603,950**	**602,502**
Year 5 Cash alue	324,055	392,932
Annual income 20 yrs	**58,950**	**82,023**
Interest rate	6% Years 1-5 then 8%	6% 1-5 then 8%

- The plan that is only **20%** deductible returns over **$23,000** a year more in retirement income or specifically **$461,460** over the 20-year period. That is **about 40% more cash** for the **SAME** out-of-pocket cost.
- The numbers on the left come from the "New" Section 79 Plan.

How should you be selling 79 Plans?

- Based on the larger deduction even though a client will have significantly less money to borrow tax-free in retirement?
- I don’t think so, but I know it’s easier to sell based on the deduction.
- I can’t tell you what to do.
- I just give you the real-world numbers and pros and cons to certain plans and you do what you think is best.

TPAs

- The one thing I do like about the “new” Section 79 Plan is the ability to use different TPAs to admin the plans.
- Typically with 412(i), 419, and Section 79 you have a TPA that takes 20% of the case.
- There is NO reason for that in the 412(i) arena (and 419 plans are dead for the most part).
- Section 79 is a little trickier of a concept to admin and enroll.

Continued

- Unfortunately, the brain trust at the company that has the new plan has chosen, unwisely in my opinion, the TPAs they currently allow to admin their plans.
- Because I receive calls/e-mails from thousands of advisors each year who tell me horror stories about working with TPAs, I know the ones to stay away from.
- And wouldn't you know it, the only four approved so far are on my list of TPAs I would **never work with** or use based on their work in the 419, 412(i) or Section 79 Plan markets.
- **Use these TPAs at your own risk**.

Continued

- I have a TPA I work with that I trust and that should be getting approved shortly.
- That's a moot point if the company doesn't fix the under 10 EE group non-medical underwriting issue as I will not recommend the plan until that gets fixed.
- What about using a Section 79 Plan with a "**good**" EIUL policy?
- The TPA that admins that plan will take 20%.
- That's life but the firm **does it "right"** and help agents with illustrations, creates sales proposals and helps with EE enrollment.
- I will have that TPA e-mail you after this webinar.
- Or you can e-mail me at info@thewpi.org for contact info.

Summary

- If you have small business owners who are good candidates to build wealth through the use of cash value life insurance, a Section 79 Plan is something you need to explore.
- I recommend using a plan with a "**good**" EIUL policy as the outcome will be better for the client.
- I recommend using the **"New" Plan** to the extent you want to use a plan with a **larger deduction**
  - So long as they get the non-medical underwriting issue fixed
  - So long as they use a TPA that I can endorse
- Having knowledge on this subject will help you provide better advice to your clients and grow your business by bringing in new clients.

Questions?

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