Course Objective

This course was created to teach advisors (CPAs, EAs, accountants, attorneys, financial planners, and insurance advisors) about a very unique type of employee benefit plan which is covered under Section 79 of the IRC.

Many of our medium to small business clients, the owners, are looking for ways to build wealth or accomplish estate planning in a tax favorable manner. The following material will describe in great detail how business can purchase cash value life insurance on the lives of the owner employees where the life policies are owned individually by the employees and where the premium for those policies is approximately 35% deductible. Many of our clients have cash building life insurance or estate planning life insurance and the premium in the normal course of planning is NOT deductible. With a Section 79 Plan, you will learn how to show clients how to buy that same cash building or estate planning policy in a tax favorable manner through their business.

Section 79 Employee Benefit Plans

Introduction

If you look in the tax code under Section 79, you will find the basic outline for a Section Titled "Group Term Life Insurance." Traditional Section 79 Plans are often sold to companies as a way to provide additional employee benefits (in the form of fairly inexpensive group term life insurance benefits).

Over the years, as with many topics, promoters have figured out how to use the tax code to make it more beneficial than it appears to be to the normal person. That is really what has happened to the Section 79 plan since promoters are now using this plan to purchase cash value life insurance policies with pre-tax corporate dollars for employee owners in small corporations.

In this section of the course we will define what a Section 79 Plan is, and how it is currently being marketed in today's marketplace. We will also review the recent 412(e)3 regulations, how these regulations have changed the way 79 Plans are sold, and how viable they are after the introduction of these regulations.

Simple Explanation of a Section 79 Plan

Before you read all the code and details surrounding a "Section 79 Plan", to better help you understand the technical material, a simple explanation of the plan is warranted.

A "Section 79 Plan" as sold in today's marketplace is fairly simple. An employer (typically a C-Corporation) will purchase a group term life insurance benefit on its non-key employees in the amount of $50,000 per employee. The cost is inexpensive and deductible to the employer (with no imputed income to the employees).

Permanent life policies (with cash value) are can be purchased under Section 79 and that's what is offered to all employees of the company. As a general statement, the premiums are 100% deductible to the employer and the employee has to recapture as income approximately 65% of the premium.

What is accomplished with this plan? An owner/employee can have his/her company purchase a "cash building" life policy and have the policy's premium 100% deductible with only approximately 65% taxable to the employee (with an extra minor cost of the insurance elected by the employees). The cash building policy is owned by the owner, who can access tax free loans from the policy in retirement.

This is a Section 79 Plan in a nutshell. The following will explain in detail why, technically, the plan works and an example of the numbers for a hypothetical client.

Group Term Life Insurance

Group term life insurance is a form of business life insurance. There are a myriad of reasons for business life insurance. Businesses often buy life insurance for their employees as a part of their compensation package because the business gets a better tax break on it, or because the business can negotiate a better deal on it than the employees could do individually.

Group term life insurance is purchased to provide special benefits and compensation packages for key employees and also to make sure that the business remains healthy financially in the event of the death of a key employee.

Almost all employers who provide health insurance coverage for their employees have a group term life policy. Most health insurance companies require that employers buy a small amount of death benefit on each employee's life (usually $5,000 per employees).

Group Term Life in a Section 79 Plan

Section 79 is generally used by employers as a way to purchase not only term life insurance but also permanent benefits (cash value life insurance) with tax deductible dollars. Some important issues that must be satisfied for a Section 79 Plan to be **valid** are as follows:

1. **The employer adopting a Section 79 Plan must be either (a) a C corporation; (b) an S corporation, but "employees" covered by the Plan do not include 2% or more shareholders; (c) a partnership, but "employees" covered by the Plan do not include partners. Because a C corporation is really the only type of entity that can cover the "key employees", this plan is not always the most attractive plan.**

2. Furthermore, all insurance policies provided to employees under each Section 79 Plan must be life insurance contracts for federal income tax purposes, within the meaning of Code Section 7702.

3. **If** a Section 79 Plan provides term life insurance containing permanent benefits to employees, the Plan must satisfy all requirements necessary to qualify as group term life insurance under Section 79 of the Code and section 1.79-1(b)(1) and (2) of the Treasury Regulations.

4. If employees pay for permanent benefits under a Section 79 Plan, in whole or in part, all payments made to the insurer by an employee must actually be paid by the employee with respect to any permanent benefits contained in the insurance policy on the life of the employee.

5. **The fair market value of an insurance policy providing permanent benefits is determined using the interim rules set forth in Rev. Proc. 2004-16 which was restated in Rev. Proc. 2005-25**.

6. **The employer paid insurance premiums constitute additional compensation to the employees**; the aggregate compensation payable to each employee involved, including all the costs of all fringe benefits and qualified plan contributions, must not exceed reasonable compensation for services rendered within the meaning of the Code section **162(a)(1).**

7. The corporation may not benefit directly or indirectly, from the policy.

What is a Section 79 Plan?

It is well understood that premiums paid by an individual for personal life insurance coverage are **not** a deductible expense for federal income tax purposes.

While premiums paid by an employer for life insurance on behalf of an employee are deductible to the employer (provided the employer is not directly or indirectly a beneficiary of the policy), such amounts generally constitute additional compensation to the employee which must be reported.

However, in certain situations, premium paid by a corporation for life insurance protection on its employees may not only be tax deductible by the employer, but also can be excluded in whole or part from the income of the insured employee.

A group term life insurance plan which otherwise qualifies under Section 79 of the Internal Revenue Code of 1986, as amended (the Code"), may provide term life insurance and **permanent benefits** (the cash value component of a life insurance policy).

Under Treasury Regulation 1.79-1, the term portion of a life insurance policy that includes a **permanent benefit** can qualify as group term insurance. **The regulations define a permanent benefit as an economic value extending beyond one policy year, such as a cash surrender value**.

Furthermore, a group insurance plan can be established using a single master policy, individually owned policies, or a combination of the two.

A **cash value** life insurance policy issued on an individual basis can qualify under Treasury Regulation 1.79-1 if:

1. The policy or the employer designates, in writing, the portion of the death benefit which is group term insurance and;

2. The part of the death benefit which is designated as group term life insurance for any policy year is not less than a certain amount determined by formula in the regulations, and;

3. An employee may elect to decline or drop the permanent benefits, and;

4. The death benefit designated as group term life insurance is not reduced because of an employee's election to decline or drop the permanent benefit.

$50,000 in Term Insurance

An employer 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 is exceeded, the cost **must be included in the gross income of the employee** and is reportable on the employee's W2 as additional compensation. This cost is determined under a table (Table I - as seen below) provided by the Service and is subject to Social Security and Medicare taxes.

Permanent Benefits

The cost of the permanent benefits is an amount at least equal to the amount determined by the use of the "deemed death benefit formula" as found in Section 1.79-3(d)(2) of the Treasury Regulations.

An employee insured under a life insurance policy containing permanent benefits, in addition to the group term benefits qualifying under Code Section 79, **may offset the amount included in the employee's income each tax year from corporate payments by the amount the employee has paid for permanent benefits**.

The cost of the permanent insurance benefits under the policy, reduced by any contributions for such benefits by the employee, will be shown on the employee's W2 in the section entitled "other compensation".

If the policy year begins in one taxable calendar year for the employee and ends in another, the cost of permanent benefits provided to the employee will be allocated first to the taxable year of the employee in which the policy year begins.

The cost of insurance is a key issue in the Section 79 Plan and is explained in more detail in the examples below.

Death Benefit Taxes

Life insurance premiums paid by the employer are deductible and the death benefit is excludable from the beneficiary's income. However, the exclusion is not available unless the insurance provided under the plan satisfies the definition of "group term life insurance." If the term insurance provided does not meet the definition of group term life insurance, the employer's premium cost is includable in the employee's income. The plan **may not discriminate in favor of key employees** and the employer may not be, directly or indirectly, a beneficiary of the insurance.

Imputed Income to Employees

Premium payments by an employer for a death benefit on an employee in excess of $50,000 are treated as imputed income to the employee. The amount to be taxed is calculated by dividing the amount of life insurance that is in excess of $50,000 by $1000, and then multiplying that by the premiums shown in the

Table below. The cost of the life insurance is calculated on a month-by-month basis. For example:

1. Enter the uniform premium table (commonly referred to as the Table I rate) at the individual insured's attained age on the last day of the taxable year.

2. Multiply this cost per $1,000 Table I rate by the number of thousands of taxable life insurance benefit (amount in excess of $50,000).

3. Subtract monthly employee contributions, if any.

4. Total each month's calculations to determine the reportable taxable income for the tax year, which is referred to as *imputed income*.

If an employee contributes to a life insurance policy through payroll deduction, the employer will deduct the cost of insurance from the employee's paycheck. The paycheck deduction will reduce the employee's taxable income. The employee will have to pay income tax only on that life insurance benefit over $50,000 that was received and the employee did not pay for.

*Uniform Premiums for $1,000 of Group Term Life Insurance Protection** Rates Applicable to Cost of Group Term Life Insurance Provided After June 30, 1999

5-Year Age Bracket	Cost Per $1,000 of Protection for One-Month Period
Under 25	$0.05
25 to 29	.06
30 to 34	.08
35 to 39	.09
40 to 44	.10
45 to 49	.15
50 to 54	.23
55 to 59	.43
60 to 64	.66
65 to 69	$1.27
70 and above	2.06

*In using the previous table, the age of the employee is his attained age on the last day of his taxable year.

EXAMPLES:

1. John works for employer XYZ. The employer purchases $35,000 of Group Term Life Insurance on John's life. Because the insurance coverage is under $50,000, the Group Term Life Insurance is not income taxable to John. Also, because John's employer pays the entire premium for this coverage his taxable (take home) income is not reduced.

2. Same as example 1 except this time John's employer purchases $75,000 of Group Term Life Insurance on John's life. Because he has more than $50,000 in coverage, the excess, or $25,000 is taxable. Using the table above, if John is 46 year old, the amount of taxable income would be $3.75/month or $45.00/year. Assuming John's employer pays all of the premiums for this coverage his taxable income is not reduced.

In this example, John would have to recapture as taxable income the $45 annual term costs of insurance for the death benefit provided which is above $50,000. If John is in the 20% tax bracket, the additional coverage would cost him an extra $9.00 a year.

3. Again, assume John's Employee purchases $75,000 of Group Term Life Insurance on his life. Because he has more than $50,000 in coverage, the excess, or $25,000 is taxable to him. Using the table above, if John is 46 the amount of taxable income would be $45.00. However, in this example, John contributes to the premium for this coverage. If John contributes $40.00 a year for her premium and this contribution is with **after tax income**, the amount to be taxed is $5.00 ($45.00 taxable income minus $40.00 after tax contributions = $5.00). If John is in the 20% tax bracket, he would pay 40 cents in taxes on the $5.00 taxable benefit.

Requirements of section 1.79-1(a) of the Treasury Regulations

The life insurance must meet four conditions to be considered group term life insurance and qualify for special tax exclusion by employees.

1. It must provide a general death benefit, excludable from gross income under IRC Section 101(a). Travel insurance and accident and health insurance do not satisfy this requirement.

2. It must be provided to a group of employees as compensation for personal services performed as an employee. Participation in

an employer's pension, stock bonus plan, profit sharing or accident and health plan is considered a factor related to employment. Insurance on the life of a self-employed person or a partner is not excludable. Similarly insurance on **S corporation employees who own more than 2%** of the stock or more than 2% of the voting power are treated like partners and thus insurance is not excludable.

3. The insurance must be provided under a policy carried directly or indirectly by the employer. A policy meets this requirement if an employer pays any or all of the cost. The policy can be a master policy or a group of individual policies.

4. The amount of the insurance provided to each employee must be computed under a formula that precludes individual selection of such amounts. The formula may be based on factors such as age, years of service, compensation or position. Employees may be excluded who have not completed 3 years of service, are part time (not more than 20 hours per week) or seasonal employees (not more than 5 months per calendar year), are represented by a collective bargaining agreement or are nonresident aliens. All benefits available to participants who are key employees must also be available to all other participants. Furthermore, the plan must benefit at least 70% of all employees, or at least 85% of all participating employees must not be characterized as "key employees".

Practice Tip

"Section 79" plans sold in today's market use the tax rules to solve the problem of providing permanent life insurance policies to the non-owner employees.

How?

As previously explained, employees will have imputed income for a death benefit purchased by the employer for the employee which is in excess of $50,000. The employer very simply offers to buy a permanent policy on the all employees. While it initially sounds like a real benefit to the employees, when they realize that they will have imputed income, virtually all employees will opt out of the permanent universal life policies for $50,000.

As a general statement, hourly employees or lower wage employees have no desire to receive "phantom income" on a life policy where the cash benefits may not be realized for 10+ years. Lower wage employees cannot afford to receive phantom income, or those who can afford it would simply rather take all of their income home, pay tax on it and spend it.

How Many Employees Equal a Group for Purposes of a Section 79 Plan?

As a general rule, life insurance provided to a group of employees cannot qualify as group term life insurance for purposes of Section 79 unless, at some time during the calendar year, it is provided to **at least 10 full-time employees** who are members of the group of employees. For purposes of this rule, all life insurance policies carried directly or indirectly by the employer are taken into account in determining the number of employees to whom life insurance is provided.

For corporations with 10 or more employees, it is not necessary to provide new insurance coverage on each employee to qualify for the 10 and over group. This is because life insurance provided under policies carried directly or indirectly by the employer must be taken into account when determining the number of employees for whom new life insurance must be provided.

Thus, an employer providing group-term life insurance to 10 of those employees can increase coverage for fewer than those 10, that is, superimpose additional coverage for some employees and not be subjected to the "under 10" requirements described below.

To qualify as an over 10 employee group, there must be at least 10 members eligible to participate in the group at some time during every calendar year the plan is in effect. **However, this does not mean that all members need to elect the "permanent benefit" option under the code section 79 plan.**

Coverage must be provided under a formula based on factors such as age, years of service, compensation, or position. The amount of insurance provided an employee under such a schedule must, however be computed under a formula which precludes individual selection.

As long as the requirements of the regulations are met, there are no limitations on the amount of insurance that may be provided for employees who are members of the eligible group, except the total compensation for each employee, including insurance premiums and other benefits, remains reasonable.

If the corporation has fewer than 10 employees, the following three requirements must be met:

1. The insurance is provided to all full-time employees, or all who provide satisfactory evidence of insurability to the insurer if evidence of insurability affects eligibility. The following employees may be excluded without affecting Section 79's "qualified status".

a. Employees who work part-time, meaning 20 hours or less per week or five months or less in any calendar year.

b. Employees who are in a waiting period which may extend up to six months before becoming eligible for company benefits.

c. Employees who continue to work after they attain age 65.

d. Employees found uninsurable by the insurer solely on the basis of information contained in a health questionnaire completed by the employee.

2. The amount of insurance provided is determined not by formula, but instead either as a uniform percentage of compensation or on the basis of coverage brackets established by the insurer.

The regulations permit two alternate methods for determining the amount of coverage which can be made available to each employee: 1) the uniform percentage of compensation method or 2) the coverage brackets method. Coverage brackets could be drawn broadly enough to fit the circumstances of most employers and must be designed to include employees in each coverage bracket.

3. Evidence of insurability affecting an employee's eligibility for insurance, or the requested amount of insurance, is limited to a medical questionnaire (no medical examination) completed by the employee.

Due to the fact that 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 or the maximum amount of premium they will accept (whichever is less). Carriers will also generally not issue anything over a Table 2 rating on this basis.

How is group term life insurance taxed if the plan is discriminatory?

Under the Internal Revenue Code and Treasury Regulations, in order for the permanent benefit life insurance program to be considered valid and provide the tax benefits described, it must not be discriminatory.

1. The plan cannot discriminate in favor of “key” employees.

2. Discrimination rules are related to the amount of life insurance on each participant.

3. Discrimination rules are determined by a formula based on such factors as years of service, compensation and job classification.

4. Employees may purchase additional benefits.

5. **Employees may elect out of the plan without affecting the plan’s discrimination status, unless they are required to contribute to the cost of the benefits other than for term life insurance.**

6. Employees can be excluded if they are members of a union, have not completed a certain number of years of service, are part time or seasonal (less than 20 hours per week or 5 months a year), are non-resident aliens, or 65 years of age or older.

If the plan covers any “key employees” and the plan discriminates in favor of them either as to eligibility to participate or with respect to the kind or amount of benefits, the key employees may not exclude the cost of the first $50,000 of coverage. A key employee in a discriminatory plan must include the higher of the actual cost of insurance or the specified uniform premium Table I cost. Employees who are not key employees may exclude the cost of $50,000 of coverage even if the plan is discriminatory.

How is “key employee” defined?

A key employee is an employee who at any time during the employer’s tax year was:

1. an officer of the employer having annual compensation greater than $135,000.

2. a more than 5% owner of the employer.

3. a more than 1% owner having an annual compensation from the employer of more than $150,000.

4. any former employee who was a key employee when he/she retired or separated from service.

What are the actual benefits of a Section 79 Plan?

1. Allows for a **current tax deduction** on contributions to the plan

2. Allows for tax deferred growth (through a cash building life policy owned individually by the employee).

3. It provides for a flexible, unlimited-funding window for key participants (although the plan is typically funded only for five years due to the fact the deductibility of the premium for permanent benefits decreased each year).

4. Employee participation requires a minimal funding outlay.

5. There are no minimum age requirements to withdraw income (no early withdrawal penalties).

6. The plan provides a non-taxable, on demand income stream.

7. Transfer of assets at the participant's death is income tax free to heirs.

Who is a candidate for a Section 79 Plan?

1. As a general rule, a client (employer) with fewer than five owners/key employees and 40 rank and file employees. (If clients have more than 40 employees, unless every owner wants to take part in the plan, the term costs of insurance for the staff makes the concept much less viable).

2. A client looking for a way to purchase life insurance in a partially deductible manner for an estate plan.

3. A client looking for a plan that does not have upper-end funding limits. There is no maximum amount of money the owner can deduct from the company for the purchase of life insurance. (However, the amount should comply with the Section 162 "reasonable and necessary" rule).

4. A client who needs to distribute corporate earnings, but avoid receiving 100% of these dollars as current W-2 income.

5. A client who wishes to retire prior to age 59 ½ or does not want to be forced to take retirement income at age 70 ½. (Since Section 79 is not a qualified plan the rules for early or forced distribution do not apply).

How does a Section 79 Plan sold in today's market really work?

Basically, a Section 79 Plan allows an employer to purchase life insurance on the employees (which include owners of the business) in a tax deductible manner.

What typically ends up happening is that the employees will opt for $50,000 in term life insurance and the key employee(s) (the owners) will opt for a Permanent Life Insurance Policy.

Life insurance premiums are paid as a corporate deduction; and if the life policy is a permanent life policy, the employee(s), with that type of policy, will have to recapture as income some portion of the deductible premium made by the employer. The $50,000 term costs for the employees should range from $75 to $500 a year per employee, which is deductible to the corporation.

One main sales pitch of the Section 79 Plan is that the permanent policies purchased have **cash value** in them so that at the end of the day, the key employee(s) will be able to take "income tax free loans" from their life policy as supplemental retirement income (or the policies can simply be used for estate planning purposes).

Generally, due to the way the permanent policies used in a Section 79 Plan are designed the plan needs to be in place for a minimum of 5 years for the cash values to build to a point that makes the cost of the insurance viable as an investment for future income. Most plans are quoted showing 5 to 7 years of contributions.

The following is a timeline of events for Section 79 Plans are implemented with a company with one owner (age 45) and four rank and file employees.

1. The key employee owner(s) decide that a Section 79 Plan is an efficient way to purchase a cash building life policy.

2. A census is taken to see how much it will cost for insurance on the four rank and file employees.

3. Life insurance applications are taken and employees go through the non medical telephone application.

4. The employees MUST be offered the same cash value policy that the owner is going to have paid for by the company under the plan.

5. The advisor implementing the plan sits the rank and file employees down and explains to them that IF they choose the permanent policy the employees must recapture as income (phantom income) the permanent cost of the policy

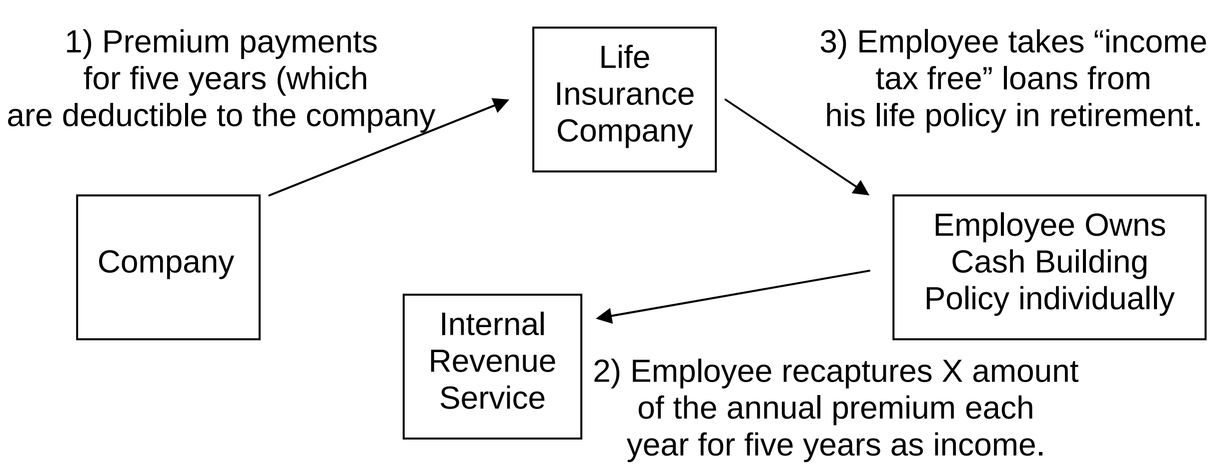
6. The low paying rank and file employees do not want to recapture phantom income of any kind and usually opt to have the employer purchase only the $50,000 of term insurance.

7. The employer then pays very little to purchase $50,000 of term life on the four rank and file employees and pays for this example $100,000 in premium for the employee/owner to fund a cash building life policy.

8. The owner of the company has to recapture approximately 65% of the premium as phantom income and in essence has created a scenario where he owns a life policy where 35% of the premium was deductible (not bad even if the employer had to pay for the term costs of the employees).

9. The employer typically pays this premium for five years and then terminates the plan.

10. The key owner who owns the cash building policy in his own name free and clear can then simply wait until retirement age and then use the policy for estate planning or for supplemental retirement income through income tax free loans from the life policy.



There are a few different Section 79 Plans in the marketplace that value the cost of insurance differently. This will be covered in the following pages through some examples.

What are the income tax consequences of a Section 79 Plan when using a cash value life insurance policy?

The promoters of the Section 79 Plan used to state that the cash building policy purchased for the business owner was 100% deductible to the corporation, however the client must include 35-40% of the premium as additional income on their W-2.

Promoters of these plans purport to reduce income tax liability by manipulating the cash value in the policies. The policies are designed by the insurance carriers to have low cash surrender values at the time they are removed from the plan and then increase in value rapidly thereafter. **However this was prior to the February 13, 2004 release by the IRS of proposed regulations issued to combat the abuses in 412(e)3 plans being marketed and sold**. (Rev. Proc. 2004-16). New proposed regulations were issued in April of 2005 (Rev. Proc. 2005-25) to clarify 2004-16.

As stated earlier, Section 79 generally requires that the cost of group term life insurance coverage on the life of an employee that is in excess of $50,000 of coverage be included in the income of the employee. Pursuant to Section 1.79-1(b) of the regulations, under specified circumstances, group-term insurance may be combined with other benefits referred to as permanent benefits.

Under Section 1.79-1(d), the employee's income includes the cost of those permanent benefits, reduced by the amount the employee paid for the benefits. The cost of the permanent benefits is determined under a formula provided in the regulations that is based in part on the increase in the employee's deemed death benefit during the year.

One of the factors used for determining the deemed death benefit is the "net level premium reserve at the end of that policy year for all benefits provided to the employee by the policy or if greater, the cash value of the policy at the end of that policy year". Amendments to the regulations under Section 79 were proposed in Rev. Proc. 2004-16 that would delete the term "cash value" from the formula for determining the cost of permanent benefits and substitute the term "fair market value". Rev Proc. 2005-25 provides guidance for determining the fair market value safe harbor formulas that were set out in Rev. Proc. 2004-16. The revenue procedure provides two safe harbor formulas that will meet the definition of fair market value for Section 79.

The fair market value of an insurance contract may be measured as the greater of:

A. the sum of the interpolated terminal reserve (ITR) and any unearned premiums plus a pro rata portion of a reasonable estimate of dividends expected to be paid for that policy year based on company experience, and

B. the product of the PERC (premiums, earnings and reasonable charges) and the applicable average surrender factor which is equal to 1.00. The PERC amount is the aggregate of:

1. the premiums paid from the date of issue through the valuation date without reduction for dividends that offset those premiums, plus

2. dividends applied to purchase paid up insurance prior to the valuation date, plus

3. any amounts credited (or otherwise made available) to the policyholder with respect to premiums, including interest and similar income items (whether credited or made available under the contract or to some other account), but not including dividends used to offset premiums and dividends used to purchase paid up insurance, minus

4. explicit or implicit reasonable mortality charges and reasonable charges (other than mortality charges), but only if those charges are actually charged on or before the valuation date and those charges are not expected to be refunded, rebated, or otherwise reversed at a later date, minus

5. any distributions (including distributions of dividends and dividends held on account), withdrawals, or partial surrenders taken prior to the valuation date.

If income is calculated with respect to premiums paid under the contract, that amount must be included in the formula, even if the income can only be realized through an exchange right that gives rise to a springing cash value under another policy.

Similarly, if a mortality charge or other amount charged under a contract can be expected to be directly or indirectly returned to the contract holder (whether through the contract, a supplemental agreement, or under a verbal understanding and regardless of whether there is a guarantee), the charge is not permitted to be subtracted under the formulas.

In addition, a surrender charge cannot be taken into account in determining an average surrender actor if it may be waived or otherwise avoided or was created for purposes of the transfer or distribution. Furthermore, if the insurance contract has not been in force for some time, the value of the contract is best established through the sale of the particular insurance contract by the insurance company (e.g., as the premiums paid for that contract).

Due to the fact that Section 79 is one of three sections in the Code that governs the income tax treatment of an insurance policy (the other two sections are 402(a) and 83(a)), the proposed regulations also changed the valuation method to Section 79 UL policies. These regulations were intended to curb the abuses in 412(e)3 Plans by clarifying what the value of a policy is for income tax purposes. The proposed regulations amend the income taxation of life insurance by clarifying that the amount to be included in income is the "fair market value", and that the fair market value may exceed the cash surrender value of the policy.

Bottom line with the income tax consequences of a Section 79 Plan

What does this all mean in the deductibility of the permanent policy being sold currently? Instead of 35-40% of the premium paid being included on a client's W-2 as other income, the amount includible is now closer to 63-65%. This change is due to the fact that the surrender charges can no longer be recognized in the calculation of the values of the policy. Some providers believe that with the new products that are being developed by carriers to comply with the proposed regulations, the amount that will be deductible by the corporation may increase anywhere from 5-10%.

Do the new proposed regulations kill the viability of these plans?

Not necessarily. For a handful of clients the Section 79 Plan still makes financial sense. It is all dependent on the age of the client and the way that the insurance company product is designed. Insurance company actuaries are currently redesigning their policies to better suit this market.

Sample Section 79 Illustration

Formula: All full time employees will receive a death benefit equal to 5.5x their annual income with a minimum death benefit of $50,000. Employees are presented with 3 options:

1. A full permanent insurance option. Here the employee must pay the safe harbor permanent cost of the insurance plus the Table I cost.

2. A full term insurance option. Here the employee must pay the Table I cost.

3. $50,000 term insurance. No cost to the employee. Most employees choose this option.

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

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

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

$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

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

Should you be recommending Section 79 Plans to clients?

The Wealth Preservation Institute's position on Section 79 Plans is that they are not financial viable given the current tax laws and products being used in the plans.

These plans are sold mainly by advisors who do not understand the math that supports their use and they are sold more on its tax deductibility instead of on the ultimate benefit to the client.

Most clients would be better of not using a Section 79 Plan and instead taking their money home, paying tax on it, and funding a "good" cash value life insurance policy.

Additionally, it is commonplace for employees to be forced to or coerced to opt out of receiving permanent benefits that business owners reap from the plan. If most of the covered employees opted for permanent benefits offered through the plan, it would be much less financially viable than it already is.

Many clients who are candidate for a Section 79 Plan are also candidates to use the affordable captive insurance company structure. This structure is a much better tool to help business owners grow wealth and one that does not require the involvement of employees. To learn about this structure, go to www.affordablecaptives.com or see the WPI educational module on captives.

