Advanced Markets

the Section 79 “Alternative”

a simple, flexible approach to provide life insurance to key persons and business owners

sales idea

Recently, it was reported that the IRS has initiated a series of tax audits on existing Section 79 Plans that were funded with permanent life insurance policies.

As a result, two major insurers that made their products available to fund Section 79 plans suspended sales activity in the section 79 market. This action increases the viability of the “Alternative” approach.

The Situation:

Bob owns a small business with three employees. Bob has been approached by another advisor suggesting he implement a “Section 79” employee benefit plan. The idea is to provide extra life insurance protection during their working years and a retirement income supplement from policy cash values.

do you have business clients

- Looking to provide benefits for themselves and selectively reward other key employees?
- Looking to supplement their retirement assets?
- Considering a “Section 79 Benefit Plan”?

He was advised that:

- All contributions would be deductible to the business.
- At least 90% of any plan contributions would be for the owners’ benefit.
- As individual participants they would be taxed on a value less than the company’s contribution; the discount could be as much as 30 to 40%.
- Any life insurance cash surrender values could supplement their retirement income.

However, he is concerned about the complexity of the plan and the annual administrative costs. Additionally, his three employees must be included and they need to concentrate their contributions into a five-year period. They are interested in spreading the company contributions over a longer time frame.

Most Section 79 Plans are used to provide group term life insurance to employees. Most major employers sponsor group term life plans. Insurance amounts are normally a multiple or percentage of salary. The first $50,000 of death benefit is available free of cost to the employee and free of any taxable economic benefit amount. For amounts over $50,000, the employee is taxed on the “economic benefit” or value of the death benefit protection using IRS Table I.

Permanent life insurance can be purchased in a Section 79 Plan as well; the tax rules provide little or no tax advantage to employees with most life insurance products.

You may also recall that in prior years, industry innovators concluded that you should be able to use individual policies, as well as group policies, and those individual policies could also provide permanent life insurance. As a result, Congress stepped in and laid out the ground rules for using permanent life insurance in conjunction with IRC Section 79. The employee participants would be taxed on the economic benefit of the death benefit and the value provided by the permanent insurance element. As a result of rule changes, for a number of years "Permanent 79" Plans had remained dormant. On a limited basis, these plans have surfaced again.

In recent versions of "Permanent 79," the group life rules (IRC Sec 79) are used in conjunction with indexed life insurance products with the goal of reducing the business owner's "after-tax outlay" by 30 to 40%. In the plans that have been available for review, the premium payment is set up as a "5-pay/quick-pay plan," with the policy being withdrawn from the plan at the end of the fifth year. The policies used are front-end loaded with the intent to suppress the policy's values in the early years, which reduces "economic benefit costs" associated with the permanent insurance element. Some versions employ an investment bucket that defers crediting account earnings until the policy is taken out of the 79 Plan, after five years. Again, the goal is to suppress the taxable value to the employee participants.

Medical underwriting is another concern that must be addressed in 79 plan design. Individual medical underwriting cannot be employed with plans that have less than 10 employee participants. Usually that means that the insurer must be willing to offer special underwriting considerations with "under 10 plans" that could require the use of a standard rate even for those participants in preferred health. As a way to overcome the underwriting limitations for under 10 plans, some companies suggest that convertible term insurance be purchased and medically underwritten outside the plan, then rolled into the 79 plan. The suggestion is that the conversion does not require medical underwriting.

The IRS has not yet voiced an opinion on this policy valuation technique, which suppresses the income tax value attributed to employees.

Purchasing permanent life insurance with the Section 79 funding approach:

- Offers minimal funding flexibility,
- Requires substantial contributions packed into a five-year time frame,
- Must offer all full-time employees the opportunity to participate,
- May incur additional costs for plan administration and the inclusion of all other employees,
- Would be limited in funding options if there are less than 10 employees to participate (insurance cannot be medically underwritten).

The Strategy — "The Alternative":

There is an alternative approach that in most cases can produce similar or better results because:

- It is simple and produces similar results to those suggested in Section 79 Plans.
- Contributions are tax-deductible to the company.
- It does not require the inclusion of all full-time employees; 100% of contributions can be directed to select employees.
- It does not require a minimum number of participants.
- It does not require a special plan or product manipulation to meet IRC and IRS guidelines.
- It does not require up-front actuarial calculations, future outside administrative fees or other compensation adjustments.

It involves:

- A bonus plan where the bonus is "grossed up" to cover both policy premium and the employee's tax associated with the plan (Double Bonus) and
- A voluntary employee contribution.

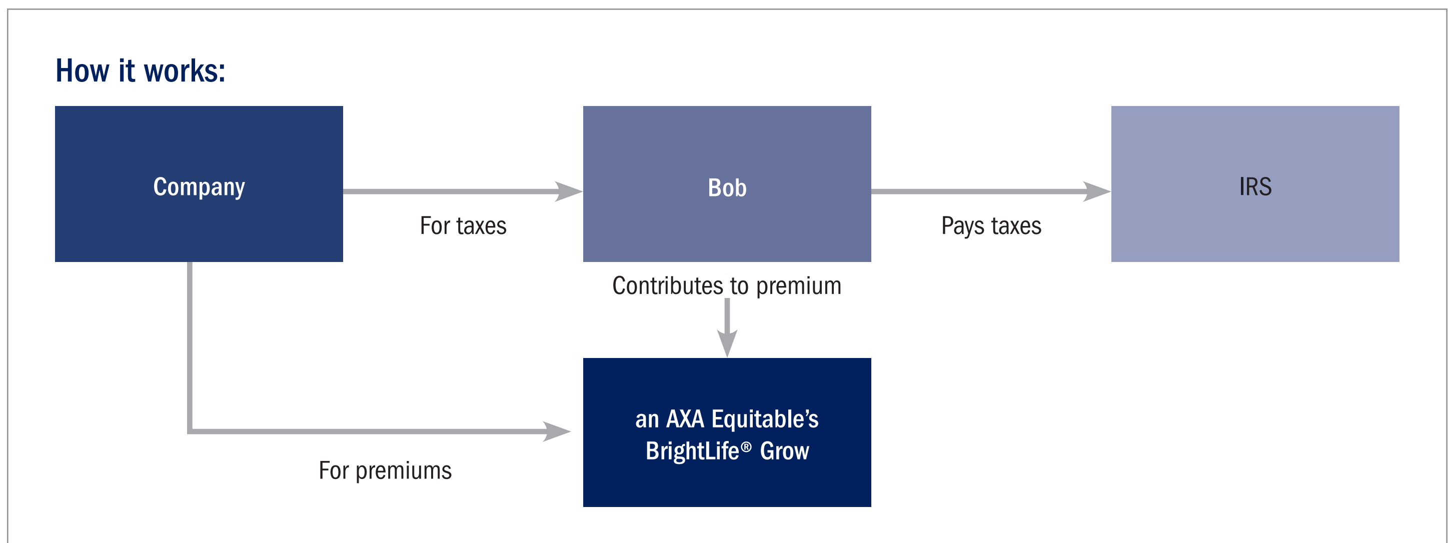
How the "Alternative" Works for Bob

For comparison, we have used AXA Equitable's BrightLife® Grow product and the same contribution stream planned for the Section 79 plan. Here we use an example with numbers for Bob. The Company is projected to make the same outlay, $50,000 a year for five years into the plan. $30,000 of this amount will be used for life insurance premium and $20,000 to cover employee income taxes. Because the employee does not have to use his or her own money to pay the taxes, the employee can contribute an additional amount toward the life insurance premium. For this comparison, the employee will be presumed to contribute an amount equal to what he/she would have paid in income taxes under the Section 79 plan proposal. The amount varies each year. For example in year 1, Bob would pay $14,298. (See table below). In this case, using the same employer and employee out-of-pocket outlays, the "Alternative" illustrated policy values were able to project a slightly higher retirement benefit.[1]

	Annual Business Contribution	Annual Business Deduction	For Section 79 Plan Bob's Annual Outlay for Taxes	For "Alternative" Bob's Annual Premium Contribution
Year 1	$50,000	$50,000	$14,298	$14,298
Year 2	$50,000	$50,000	$13,822	$13,822
Year 3	$50,000	$50,000	$13,714	$13,714
Year 4	$50,000	$50,000	$13,278	$13,278
Year 5	$50,000	$50,000	$12,842	$12,842

How the benefits work for Bob (15 years income from age 71 to age 85)

Section 79 Plan - $67,344
Executive Bonus Section 79 Alternative - $72,546



What Have You Achieved?

With the same outlay and same time frame as provided in the Section 79 Plan Sample, the "Alternative" produced similar results. **However, the "Alternative" can offer:**

- Flexibility in plan design.
- Company contributions can be spread out over a greater number of years.
- Employee contribution amounts can be made in larger or smaller amounts.
- Employee participants are not locked into a set "out-of-pocket" amount — most Section 79 plans require a five-year heavily funded outlay to work, after which the product funding is terminated.

The "Alternative" addresses the attributes that Bob liked about the Section 79 Plan:

- It is tax-deductible to his corporation.
- It provides his employees with life insurance protection and supplemental retirement income.

The "Alternative":

- Reduces the complexity common with Section 79 plans.
- Eliminates the cost impact if his other three employees were included.
- Eliminates the cost impact of annual administrative costs.
- Allows for the ability to spread the cost (premiums) over a longer time frame.
- The tax rules are clear.
- Available with all business forms.
- Does not have plan limitations based on having less than 10 employees.
- Does not require a TPA.
- Does not require a commission split.
- Reduces risk of IRS audit.

Do you have a case to compare? Contact AXA's Advanced Markets Department for support with the "Alternative."

Why AXA?

Many reasons: Competitive-cash-value product options, breadth of portfolio, illustration support capability. AXA Equitable and MLOA maintain a strong life insurance portfolio. AXA Equitable and MLOA's products and riders offer significant planning opportunities where policy cash values are important to planning concepts like the Section 79 Alternative. You want the confidence that the insurance company you choose has the financial strength to fulfill its obligations to you now and in the future. AXA Equitable and MLOA, premiere providers of life insurance products, have been helping individuals reach their most important goals.

For More Information, Call the Life Sales Desk or Visit www.axa.com.

1 The Section 79 Plan projects a retirement supplement, from age 71 until age 85, of $67,344 per year. The "Alternative" projects a retirement supplement, from age 71 until age 85, of $72,546 per year. This is based on an illustration for a $1,054,515 Death Benefit on a 45 year old with an underwriting status of preferred no tobacco male; it is based on illustrated rate of 6.00% and current expenses. At guaranteed rates and charges, the policy will fail in year 22.

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