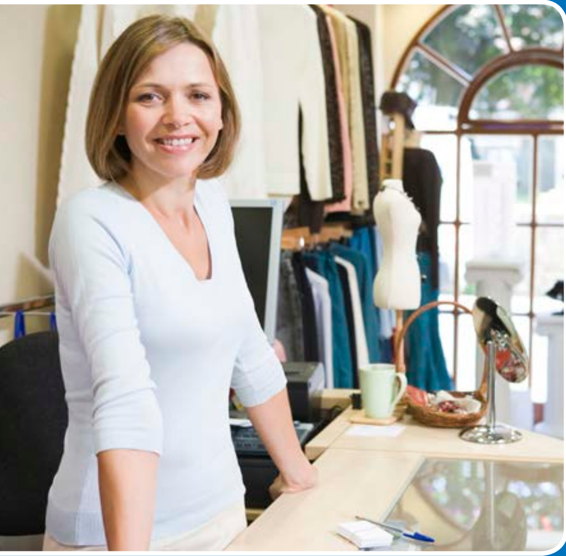
Lafayette Life Retirement Services



Life Insurance *in a* Qualified Retirement Plan

Lafayette Life Insurance Company

A member of Western & Southern Financial Group

DESIGN ADMINISTRATION FUNDING

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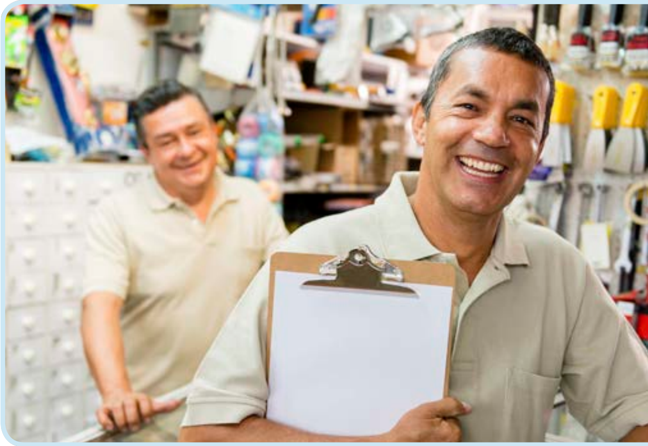
Life Insurance *in a* Qualified R

Small businesses sometimes choose to purchase life insurance as a funding option for their qualified retirement plan. There are a number of advantages in doing so:

- **Tax-Deductible Premiums.** Because the premiums are generally tax-deductible, it can be a cost-effective method of purchasing life insurance.
- **Income Tax Advantage at Death.** Policy proceeds in excess of the policy's cash value are tax-free to the policy beneficiary at death.
- **Reduced Personal Expense.** Using life insurance as a plan funding option may reduce the need for participants to spend personal income on insurance premiums.
- **Pre-Retirement Death Benefit.** Life insurance within a qualified plan may provide additional protection to the participant's family if the participant dies prior to retirement.
- **Easily Understood Benefit.** Life insurance provides a tangible benefit to eligible employees, including those who are just starting out or those with minimal accrued benefits.
- **Conservative Plan Funding.** Compared to more aggressive options, using life insurance is a conservative approach to qualified plan funding.



- **Guaranteed Issue and Simplified Issue.** Participants with health concerns may be able to purchase a limited amount of guaranteed or simplified issue insurance.

Advantages in a Qualified Retirement Plan

To purchase life insurance outside the plan, an individual bears the entire cost of the premium. Compare this to life insurance as a qualified plan funding option. The same individual is only responsible for paying the current year's taxes on the PS-58 cost.

As shown in the above example, purchasing life insurance through a qualified plan can be cost effective for the business as well as an added benefit to eligible employees.

How Does it Work?

Life insurance as a qualified retirement plan funding option

Individual Life Insurance

Let's look at an individual who purchases insurance *outside* of a qualified plan. First of all, the premiums are *not* tax deductible. That means personal income must be sufficient enough to pay both the insurance premium as well as the tax on his earnings.

- For example, assume an individual (age 40) has an annual insurance premium of $2,232 for a whole life policy with a death benefit of $100,000.
- If this individual is in the 30 percent tax bracket, he will have to earn $3,188 to have $2,232 available after taxes to pay the insurance premium.

Distribution Options for Life Insurance within a Qualified Plan

If a participant's vested balance includes life insurance, they typically have four options:

- **Take the Life Insurance as part of their distribution.** This moves the ownership of the life insurance over to the participant, and allows them to maintain the existing policy. The fair

market value minus the PS-58 cost of the policy creates a taxable event. Life insurance cannot be rolled over into an IRA.

- **Purchase the Life Insurance as part of their distribution.** If the participant wants to defer the taxation of the value of the policy to a later date, the participant has the option of purchasing the policy from the Pension Trust. This means the participant writes a check to the Pension Trust in an amout necessary to put the plan in the same cash position if the policy had been retained by or surrendered to the plan. The purchase amount is added to the investment account, and the entire vested balance is eligible to be rolled into an IRA.
- **Take a maximum policy loan and move ownership to the participant.** Perhaps the participant wants to retain the life insurance and roll over their vested balance into an IRA, but does not have the money available to buy the policy. Taking a maximum policy loan provides an option.

By the plan taking a maximum policy loan, the cash value in the life insurance policy is negligible after the loan, and the ownership can be transferred to the participant. The policy loan proceeds then go into the participant's account balance, which is then rolled over. This allows the participant to meet with both goals of rolling over the entire benefit and also retaining the existing life policy, although the policy will then be subject to the terms of a policy loan that could cause a policy termination if not repaid.

- **Surrender the Insurance.** If the participant does not need the life insurance, they can simply surrender the policy. The cash value of the policy is then added to the remaining investments and becomes part of the participant's account balance, and the vested balance is distributed.

Life Insurance in a Qualified Retirement Plan

However, if the same policy is purchased *within a qualified plan,* the plan pays the insurance premium and the employer may, subject to limits, deduct this amount as a business expense. The participant must only pay the current tax on the "reportable income" (also called a PS-58 cost) for the annual value of the current life insurance protection.

- Using the same example, let's assume the reportable income is $110.
- In a 30 percent tax bracket, the participant pays $33 in taxes. The participant needs to earn $47 to pay the $33 due in taxes.

Experience the Lafayette Life Difference

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