

## 412(e)(3) Defined Benefit Pension Plans

### Retirement Planning

In order to be successful, small business owners must be experts in their trades. But like all business professionals seeking longevity, they must also develop a knack for financial prowess—for their business as well as for personal matters. Wealth accumulation and retirement savings become more important as businesses prosper and owners begin dreaming of retirement. Lafayette Life can help the business owner navigate the way to retirement.

### Introduction to 412(e)(3) Defined Benefit Plans

What are 412(e)(3) defined benefit plans and why is everyone talking about them? It may surprise you to know that 412(e)(3) defined benefit plans have been around for over 50 years. Two factors that have contributed to the interest in 412(e)(3) plans are, the market risk associated with the stock market compared to an annuity contract with guaranteed minimum interest rates, and retirement is rapidly approaching for all the “baby boomers.”

### Requirements

A 412(e)(3) defined benefit plan is authorized by the Internal Revenue Code Section 412(e)(3), previously authorized by Section 412(i). The tax code requires plan funding solely by qualified insurance products. Plans can be funded using life and annuity products, or annuity only. The contracts must provide for annual, level premiums. Funding begins when a participant enters the plan and ends at the participant’s retirement date. Plan benefits are provided by insurance contracts. The Lafayette Life Insurance Company offers whole life insurance and indexed annuity products that are used for funding.

### 412(e)(3) Defined Benefit Plan Funding

In a 412(e)(3) defined benefit plan, the funding is for a specified benefit at retirement.

The plan can be funded, in part or wholly, with an annuity product. If the guaranteed minimum interest rate for the annuity contract is 1%, the interest earned over 1% is considered excess interest. The excess interest, if any, will decrease the future out-of-pocket contributions.



The insurance products do not guarantee excess interest. Because future contributions are decreased by any excess interest, generally out-of-pocket contributions will be higher during the earlier years of a 412(e)(3) plan. The tax deduction is determined by the out-of-pocket contribution amounts.

### Advantages of 412(e)(3) Defined Benefit Plans

- › Guaranteed benefits (provided that annual, level premiums have been paid).
- › Tax deductions.
- › Larger contributions for older employees.
- › Availability of life insurance with tax-deductible premium.

### Considerations

- › Requires annual funding.
- › Plan sponsor must have cash flow to fund at the beginning of each plan year.
- › Participant loans are not permitted.



**Lafayette Life  
Insurance Company**

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**Retirement Services**

DESIGN

ADMINISTRATION

FUNDING

## Questions and Answers

**Q. What is a 412(e)(3) defined benefit plan?**

**A.** It is a defined benefit pension plan whose annual contribution is calculated under the rules of Internal Revenue Code (IRC) Section 412(e)(3). It is also referred to as a “Fully Insured Plan,” or an “Insurance Contract Plan.” The plan is funded exclusively with insurance products.

**Q. Why would a business owner adopt a 412(e)(3) plan?**

**A.** Adopting a 412(e)(3) plan can be an important financial tool for retirement planning. It provides an opportunity to achieve retirement goals without stock market risk to the principal.

**Q. Who can adopt a 412(e)(3) plan?**

**A.** All business entities are eligible for a 412(e)(3) defined benefit plan. This includes sole proprietors, partnerships, C corporations, S corporations, and limited liability companies. The business entity must have stable income, as fluctuating income can create potential funding problems.

**Q. How do I evaluate a 412(e)(3) plan for my business?**

**A.** Your representative will collect census data and other pertinent information. A retirement plan proposal will be prepared based upon your objectives and funding goals.

**Q. Who is included in a 412(e)(3) defined benefit plan?**

**A.** The eligibility requirements generally are: employees must be 21 years old, and have one year of service that included 1,000 hours. Once employees have met the eligibility requirements, they are included in the plan.

**Q. How do I know when an employee is an eligible participant and how much to contribute?**

**A.** A retirement plan service provider helps track the employees and the required contributions. The Lafayette Life Insurance Company provides this service.

**Q. Do 412(e)(3) plans have a vesting schedule?**

**A. Yes.** One of the advantages of a qualified retirement plan is the vesting schedule. Most plans use a vesting schedule that requires employees to work for an employer a specified period, such as six years, before they are 100% vested. If a participant’s employment is terminated before they are vested, the nonvested portion of their account is forfeited and remains in the plan.

**Q. How do I fund a 412(e)(3) defined benefit plan?**

**A.** The plan is funded exclusively with annuity and life insurance, or annuity only. The benefits are guaranteed by the contracts provided the annual premiums have been paid.

### Plan Comparison

#### Maximum Contribution for an Owner

- Compensation \$330,000 | Age 55
- Retirement age 62

Contributions are for illustration purposes. Actual contributions may vary. Contributions are calculated based upon individual census data. Annual contributions for defined benefit plans (traditional, cash balance and fully insured) are required. Annual contributions for 401(k) and profit sharing are discretionary. Values as of 01/01/2023.

RETIREMENT PLAN	MAX CONTRIBUTION
401(k) Plan	\$22,500 Deferrals \$7,500 Catch-up
Profit Sharing Plan	\$66,000
412(e)(3) Plan—Annuity only	\$306,294
412(e)(3) Plan—Annuity and Life Insurance	\$428,014

**Q.** *What are the advantages of life insurance in a 412(e)(3) plan?*

**A.** The advantages are:

- Tax-deductible premium.
- Pre-retirement death benefit.
- Income tax advantage at death.

**Q.** *Can I skip funding a year if my business is down?*

**A.** No. A 412(e)(3) plan is a pension plan that requires annual funding.

**Q.** *Once I adopt the plan, can the contribution formula be changed?*

**A.** If your business or cash flow increases or decreases, you may want to change the contribution level. There are specific time periods when the plan can be amended. If contribution flexibility is a requirement, you may want to consider a profit sharing plan.

**Q.** *Can a participant in a 412(e)(3) defined benefit plan borrow under the plan?*

**A.** No loans are allowed under 412(e)(3) rules.

**Q.** *Can I adopt a 412(e)(3) plan if I have a retirement plan?*

**A.** Your options for the current year depend on various factors, such as the type of plan and the contributions made for the current year.

**Q.** *Can I adopt a 401(k) plan if I sponsor a 412(e)(3) defined benefit plan?*

**A.** An employer can sponsor a defined benefit and a 401(k) plan. The 401(k) salary deferrals do not impact the contribution to the defined benefit plan. Adopting a 401(k) plan provides the opportunity for additional retirement savings on a discretionary basis.

**Q.** *How do I start a 412(e)(3) defined benefit plan?*

**A.** The steps are:

1. Review the retirement plan proposal presented by your Lafayette Life representative.
2. Adopt the plan by signing the Adoption Agreement.
3. Fund the plan.

**Q.** *Why should I select Lafayette Life?*

**A.** Lafayette Life is not a newcomer to 412(e)(3) defined benefit pension plans. We have been providing services and funding products for 412(e)(3) plans for over 50 years.

**The advantages we offer are:**

- ▶ One service provider for the plan document, funding, annual valuation and federal filings.
- ▶ Services provided by a knowledgeable and experienced pension staff.
- ▶ Your local representative services the account.

Thank you for the opportunity to present the 412(e)(3) defined benefit plan as a retirement option.

## The Lafayette Life Insurance Company

With more than 115 years of service to policyholders, The Lafayette Life Insurance Company is a financially strong provider of individual life insurance, annuities, and retirement and pension products and services.

Lafayette Life is a member of Western & Southern Financial Group, Inc., a family of financial services companies whose heritage dates back to 1888. With the strength of our organization and our ongoing commitment to servicing you, your business and your family, The Lafayette Life Insurance Company is a company you can depend on. Find out more about our financial strength and distinguished history at [www.LafayetteLife.com](http://www.LafayetteLife.com).

**Life insurance and annuity products are not bank products, are not a deposit, are not insured by the FDIC nor any other federal entity, have no bank guarantee and may lose value.**

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The Lafayette Life Insurance Company provides services to pension plans as outlined in a separate Administrative Services Agreement, and issues life insurance and annuity products that may be used as funding options. This material is for informational purposes only. Lafayette Life does not serve as plan administrator or fiduciary, nor does Lafayette Life or its representatives provide ERISA, legal or tax advice. Your personal or legal tax advisors should always be consulted and relied upon for advice.

The Lafayette Life Insurance Company, Cincinnati, Ohio, operates in D.C. and all states except New York, and is a member of Western & Southern Financial Group, Inc.

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