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POINTERS

Will The Plan Fit?

Employers and employees come in many shapes and forms. Before proceeding with recommendations as to a specific benefit plan, it is essential to ascertain whether your client is doing business as a C corporation, S corporation, partnership, limited liability company, or sole proprietor (see pages 292-300, 408, 464, 493, 495, 499, 511, and 539-541). In general, the S corporation, partnership, and sole proprietorship provide limited opportunities for creative employee benefit plans for the owner/employee (pages 184-186).

In contrast, C corporations are taxable entities, separate and apart from their stockholders. They offer attractive opportunities for using tax-advantaged employee benefits for employee/stockholders. For example, a deferred compensation plan can be used in the medium to large sized corporation to reward key executives who are stockholders in the corporation (page 241). However, deferred compensation is not appropriate if your client is a sole proprietor. The threshold question is simple: are your client and his business separate taxable entities? If they are, then your client is able to use a "business check" for funding employee benefits, and can take advantage of any tax leverage provided by the difference between employer and employee income tax brackets (see pages 206-207).

Because of recent tax changes, consideration should be given to the tax status of the business. In recent years, individual tax rates were generally lower than corporate tax rates – helping to drive many businesses to select subchapter S status. However, today, top individual tax rates are higher than corporate tax rates. As a result, it is becoming more common to see businesses convert to C status.

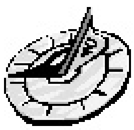
You should refer to the following footnotes for guidance regarding the appropriateness of specific employee benefits: group insurance (footnote 1, page 211); executive equity (footnote 2, page 219); split-dollar insurance (footnote 2, page 227); deferred compensation (footnotes 1 and 7, page 243); disability income plan (footnote 1, page 251); and health reimbursement arrangements (footnote 1, page 255). See also the discussion of Top-Hat Plans on page 570.

With Whom Are You Working?

It is also important to consider *whom* you are working with and what their objectives are. Is your client the owner of a small closely held business who wants to fund his corporate buy/sell agreement with split-dollar life insurance, or is your client the chief financial officer of a larger corporation charged with the responsibility of assembling a selective supplemental retirement plan for a group of key executives? Is the benefit for a "pure" employee (i.e., a nonowner)? Is the nonowner/employee related to your client? Is it expected that the nonowner/employee will eventually become an owner? Answers to these questions will help you design an employee benefit plan that is responsive to your client's objectives. A relevant and responsive plan improves your credibility with your client, and is far more likely to be accepted and implemented.

Time Can Work For You … And Against You.

Dollars can grow, but they need time. Some people have more time, and some people have less time. If you are just starting out, time is your friend; the stock market will go up, maybe not



today, tomorrow, next week, next month, or even next year, but it will go up. If you are about to retire, time is *not* your friend, particularly if you did not take advantage of time when it was your friend. By allowing before-tax dollars to grow tax-deferred, tax-favored retirement plans offer a very effective way of using time to secure your retirement years. The materials on pages 264-267, 318, 323, 596, and 597, will help you better understand and explain concepts involving the time value of money.

Education Funding And Taxation.

Many educational tax benefits that were scheduled to expire at the end of 2012 have been either extended or made permanent by the American Taxpayer Relief Act of 2012. These include the $2,500 American Opportunity Credit (extended through 2017); the $5,250 education assistance exclusion (made permanent); and the $2,000 maximum contribution to Coverdell Education Savings Accounts including elementary school expenses as qualified expenses (made permanent). To help sort out the multiplicity of these education tax incentives and their interrelationships, see pages 293, 313, 351, 353, 366, and 547.

Life Insurance In Qualified Plans.

Qualified plans can offer an attractive way of using pretax dollars to purchase life insurance for the benefit of plan participants. In pension plans the plan trustee determines to purchase life insurance as a plan asset. In defined contribution plans, such as profit sharing and 401(k) plans, participants have the ability to elect to purchase life insurance with part of their accounts (e.g., from self-directed accounts). See generally, pages 436-437.

Providing For Retirement.

Minimum distribution rules. With qualified retirement plans there are strict rules regarding when, how much, and for how long money can be put away (pages 268-283, 306-312, 430-432, and 553-555). The minimum distribution rules allow your clients to significantly defer income taxes with post-retirement and post-death distribution planning, particularly with regard to IRAs (pages 430-432 and 587). Under rollover rules your clients have a great deal of flexibility to transfer, or consolidate, their retirement funds between IRAs, 403(b) plans, 457 plans, and qualified plans including 401(k) plans.

Retirement income planning. Retirees are living longer, healthier, and more active lives (see table, Healthy Life Expectancy, page 593). No longer is it adequate to merely help clients save for retirement. Your soon-to-retire clients must have a plan that will provide an inflation-adjusted stream of income that will not be outlived (see pages 530-531). In this regard, see the Longevity In Retirement table on pages 594-595. This table can be used to estimate the odds of living to a specific retirement age. For example, a 65-year-old male has a 55.6 percent chance of living to age 80, and a 34.6 percent chance of living to age 85; but only a 15.5 percent chance of living to age 90. Given those odds, a healthy 65-year-old male should be very concerned about having sufficient retirement funds for at least the next 20 years (age 85), if not the next 25 years (age 90).

Contribution limits. Many contribution limits for employee retirement plans were increased in 2015; to include an increase in the Section 415 defined contribution limit to $53,000 and the defined benefit limit to $210,000(same as 2014), and an increase in the elective deferrals for traditional and safe harbor 401(k) plans, 403(b) plans, TDAs, SEPs, and Section 457 plans to $18,000. See table on page 309.

Self-employed individuals. A variety of retirement plans are available for the self-employed. The discussion on page 551 generally lists them in the order of amount of maximum annual contribution, costs to set up, complexity, and difficulty of administration.

Disability, Long-Term Care, And IRAs.

As with retirement planning concepts, disability income, long-term care, and IRAs are included in this employee benefits section. However, these important needs may well be provided for outside the context of an employer-employee relationship. For example, some of your clients will establish IRAs that have nothing to do with their employer, while other clients may participate in SIMPLE IRAs established by their employer (pages 424 and 554). Likewise, many clients acquire individual disability income contracts outside of a formal disability income plan; while other clients are covered by plans with varying degrees of employer participation (pages 244-247, 248-251, 326, and 378).

Long-term care. Long-term care planning is an important part of financial and retirement planning. Therefore, long-term care has been included in this employee benefits section together with the subjects of retirement and disability planning. In 2014 average nursing home costs were almost $80,000 per year (see chart, page 261). The average stay is over 800 days with about 10 percent staying for 5 years or more.

Minors and IRAs. IRA accounts are the major asset many of your clients rely upon for their retirement. Given the size of these accumulations, IRA owners often desire to control the timing and nature of distributions to IRA beneficiaries while fully maximizing the benefits of tax deferral for their beneficiaries. In this regard, see the discussions of Minors And IRAs on page 482 and See-Through Trust on page 549.

TAXATION OF EMPLOYEE BENEFITS

Employee benefits, once considered an "addition" to wages, are now become an integral part of virtually all compensation packages. This overview evaluates the tax attributes of various employee benefit plans.

Characterization of a benefit as either bad, better, or best, can be made according to its effect upon the income taxes of the employer and the employee. For example, assume that in 2014 we have an employer in a 34 percent marginal tax bracket and an employee in a 25 percent tax bracket.[1]

BAD. A bad employee benefit is one that is *nondeductible* to the employer yet *taxable* to the employee, such as one that results in unreasonable compensation or is treated as a dividend. Because it is nondeductible, on each $1.00 of income the employer must pay 34 cents in taxes. Since the remaining 66 cents is taxable to the employee, 17 cents of employee taxes will further reduce the original $1.00 to only 49 cents.

BETTER. A better employee benefit is one that is *deductible* to the employer, although still *taxable* to the employee. Since there are no employer taxes, the full $1.00 is taxable income to the employee. Now 25 cents goes to pay employee taxes, and the remaining 75 cents actually benefits the employee.

Better benefits include salary allotment plans, executive equity plans, split-dollar insurance, survivor income plans, disability income plans, and deferred compensation.

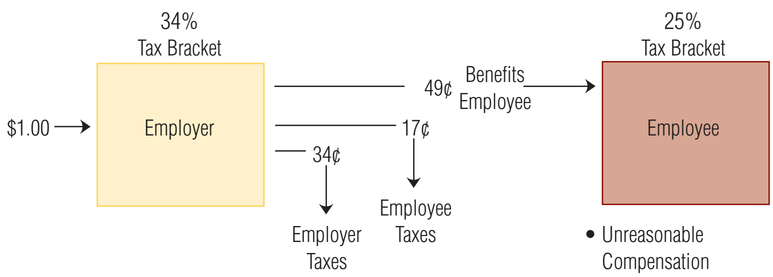
BEST. The best employee benefit is one that is *deductible* to the employer and either *nontaxable* or *tax deferred* to the employee. Now the entire $1.00 benefits the employee, without any current reduction for either employer or employee taxes.

"Best" benefits include group term insurance, medical expense reimbursement plans, SIMPLE IRAs, and qualified retirement plans, including 401(k) plans[2]

[1] However, for the first time in recent memory, it is possible for the corporate income tax rate to be less than the individual income tax rate. For this reason, it is very important to consider relative tax brackets when considering employee benefit planning.

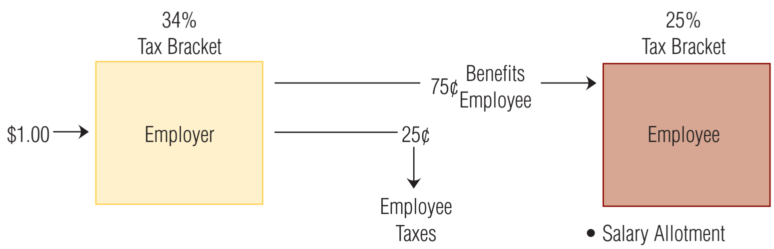
[2] Specific benefits may not be available to all employees and employers. Although SIMPLE IRAs and qualified retirement plans, including 401(k) plans, are listed among the "best," it must be recognized that the employee pays taxes when retirement income is actually received. Tax-free group term insurance is limited to $50,000 of coverage. The term "leveraged benefit" can be used to describe some of the best employee benefits, as discussed further on page 434.

BAD



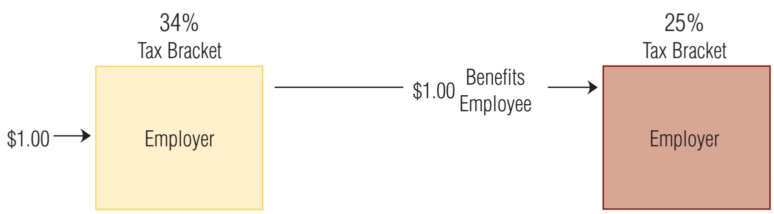
- Unreasonable Compensation
- Dividends

BETTER



- Salary Allotment
- Executive Equity
- Bonused Split-Dollar Insurance
- Survivor Income Plans
- Disability Income Plans
- Deferred Compensation

BEST



- Group Term Insurance
- Medical Expense Reimbursement Plans
- SIMPLE IRAs
- Qualified Retirement Plans
- 401(k) Plans

GROUP INSURANCE

Group insurance has gained wide acceptance as a tax-favored benefit that an employer can provide for his employees, including stockholder-employees.[1] In meeting the twin objectives of family security and reduced cost, most plans offer group term life insurance together with group hospital, surgical, and major medical coverage. Under a properly designed plan, employees can receive up to $50,000 of life coverage, free of income taxes on the premium payments.[2]

DURING LIFETIME. To provide this benefit, an employer will arrange for the insurance coverage and pay the premiums to the insurance company. These premiums are tax-deductible to the employer, but *not* taxable to the covered employee.

Group term life insurance must meet four basic requirements:

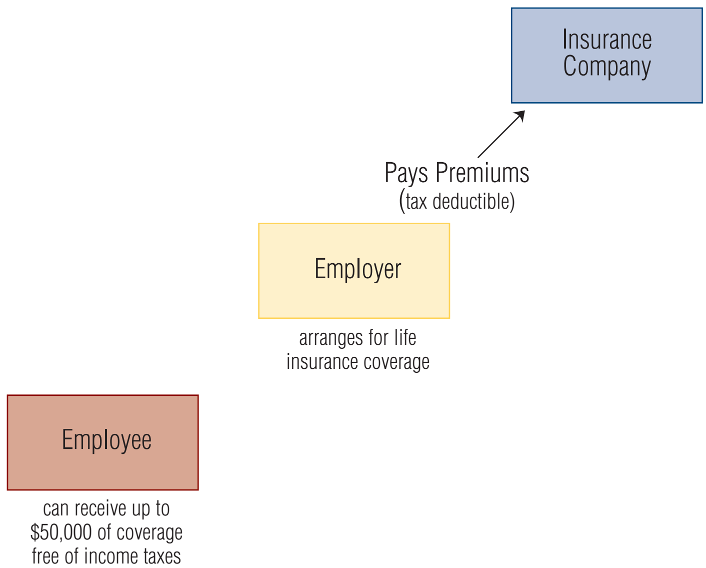
1. The plan must provide a general death benefit that is excludable from income.
2. It must be provided to a group of employees as compensation for personal services as an employee.
3. The insurance must be provided under a policy carried directly or indirectly by the employer.
4. The amount of insurance provided each employee must be computed under a formula that precludes individual selection of such amounts. This formula must be based upon factors such as age, years of service, compensation, or position.[3]

If a group insurance plan *discriminates* in favor of "key employees," then these particular employees may not exclude the cost of the first $50,000 of coverage.[4]

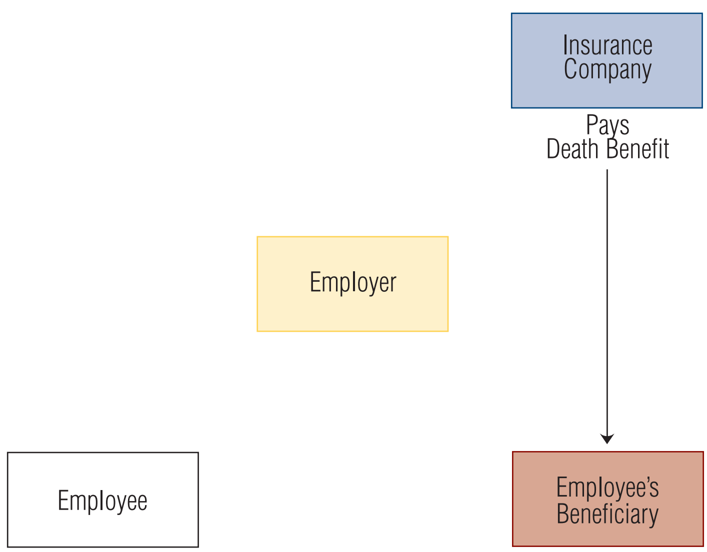
UPON DEATH. When the employee dies, the insurance company pays the death benefit directly to the employee's family or estate, as beneficiary of the insurance.[5] This payment is also free of income taxes as the death benefit of a life insurance contract.[6]

Footnotes on page 211

DURING LIFETIME



UPON DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Names of employees.
2. Dates of birth.
3. Salary schedule.

To Determine Eligibility for Program

4. Nature of business.
5. Number of years business has been in existence.

To Exclude Ineligible Employees

6. Status of employees – hours worked per week.
   – months worked per year.
7. Employment dates.

Note: It is also possible to exclude employees who are: (1) covered by a collective bargaining agreement; and (2) nonresident aliens who received no earned income from the employer from sources within the United States.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 224. Tax benefits of group term life insurance.
Q 225. Requirements of group term life insurance.
Q 227. Groups of fewer than 10 employees can be covered.
Q 228. Premiums paid are deductible business expenses.
Q 229. Taxation of cost of coverage to insured employee.
Q 232. Taxation of key employees when plan discriminates in favor of them as to eligibility, kinds or amounts of benefits (including definition of "key employee").
Q 234. When cost of coverage is subject to social security tax.
Q 235. What information returns must be filed by employer.
Q 236. Advantages of group carve-out plans.
Q 284. Use of group term life insurance to fund buy/sell agreement will likely cause denial of deduction to employer.

Footnotes

[1] The tax advantages of group insurance can be made available to the *employees* of a corporation, a partnership, or a sole proprietorship. However, this *does not include* the stockholder-employees of an S corporation who own more than 2 percent of the stock, the partners of a partnership, and the sole proprietor. They are not treated as "employees" for this purpose. Stockholders of a regular C corporation, who are also employees, can be covered by the plan as employees. Insurance provided for a non-employee corporate director does not qualify as group insurance.

[2] It is surprising to find how often corporate owners have failed to provide the maximum amount of tax-free coverage for themselves and their key employees. Although federal law allows up to $50,000, state law may set lower limits on the amount of coverage that can be provided by group life insurance. The coverage in excess of $50,000 is taxable income to the employee. To determine the value of this excess coverage, refer to the Table I Rates on page 588. This table is specifically provided by IRS Regulations to measure the value of group term insurance in excess of $50,000. In Notice 89-110 the IRS has indicated that up to $2,000 of coverage on spouse and dependents will also be income tax-free to the employee as a "de minimis" fringe benefit. Although retired employees are generally subject to the same limits as active employees, the $50,000 limit does not apply to disabled retirees.

[3] Generally, there must be at least 10 full-time employees for a plan to qualify as group term life insurance. However, insurance for *fewer than* 10 employees may also qualify as group term life insurance if: (1) it is provided for all full-time employees; and (2) the amount of protection is computed either as a uniform percentage of compensation or on the basis of coverage brackets established by the insurer under which no bracket exceeds 2½ times the next lower bracket, and the lowest bracket is at least 10 percent of the highest bracket.

[4] Discrimination as to either *eligibility to participate*, or with respect to the *kind or amount of benefits*, will result in "key employees" having to include in income the higher of actual cost or Table I cost of the entire amount of coverage (see the definition of "key employee" on page 307).

[5] One note of caution regarding group term life insurance – do not attempt to use the death benefits to fund an obligation to purchase the insured's business interest. The adverse tax consequences can be very costly. For example, if there is an attempt to fund an entity purchase agreement (chart, page 131) by making the employer a beneficiary of the policy, the Code specifically prohibits any deduction for the cost of coverage on the life of an employee. In addition, state laws often prohibit the employer from being named beneficiary of group insurance. If there is an attempt to fund a cross purchase agreement (chart, page 135) by naming a co-owner beneficiary of the policy, the arrangement is likely to run afoul of the transfer for value rules (discussion, pages 573-574). Group term insurance is an *employee* fringe benefit, the death benefit of which should be paid to the employee's personal beneficiary. Such a personal beneficiary could properly include the trustee of an irrevocable life insurance trust, to which the insured had assigned ownership of the coverage in order to exclude the death proceeds from his taxable estate. In this regard, refer to the Life Insurance Trust chart on page 51.

[6] Over the years a variety of benefits have been offered as "group" term insurance. Included among these were Retired Lives Reserves (RLR) and "Section 79." RLR (discussion, page 529) was a fund established for continuing group life insurance for retired employees: whereas, Section 79 is used to describe the use of individual permanent policies, often by superimposing them on top of existing group coverage, to provide group term life insurance.

SALARY ALLOTMENT

The compensation provided to most employees consists of both salary and benefits. Benefits can often equal 30 percent or more of direct payroll costs.[1] With a salary allotment plan, it is possible to contain these expenses, while at the same time offering a valuable benefit with *no direct cost* to the employer.[2]

A salary allotment plan can also be very attractive to employees. By purchasing a base of permanent life insurance during his working years, an employee can avoid the prohibitive costs often associated with converting group life insurance upon retirement. This then guarantees that some life insurance will always be available, whether death occurs before or after retirement.

Under the typical salary allotment plan, employees are given the opportunity to supplement their existing group and other coverages with life insurance, disability income insurance, long-term care insurance, or annuity benefits. This is a purely voluntary program, which each employee can take advantage of through an individual pay allotment to the insurance company.

The advantages of such plans often include:

- Discounted premiums from group billing efficiencies.
- No physical examinations.
- Level premiums that do not increase.
- No lapse of policy upon retirement.
- Convenient payroll deduction of premiums.[3]

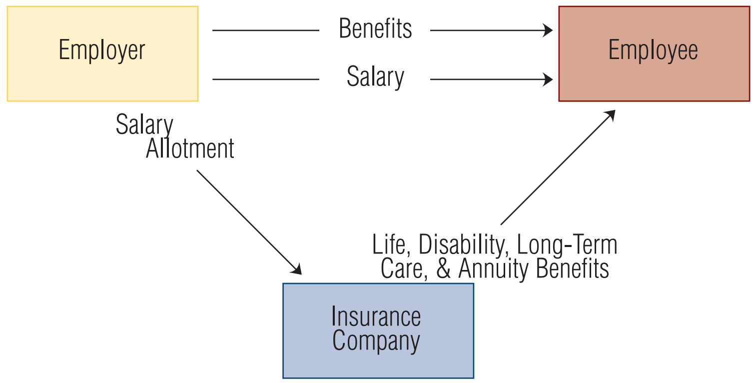
To make these benefits available, the insurance carrier will usually require the employer to:

- Provide notice of enrollment opportunity.
- Allow for enrollment at work during business hours.[4]
- Arrange for payroll deductions.

Most employers have found that their employees are grateful for the opportunity to enroll in such plans, since they are often viewed as an extension of existing benefits packages. These plans offer a relatively painless means by which employees pay modest premiums in order to provide substantial life, disability, and annuity benefits for themselves and their families.[5]

Footnotes on page 215

COMPENSATION



THE ADVANTAGES

- Discounted Premiums
- No Physical Examinations
- Level Premiums
- Permanent Coverage
- Payroll Deduction

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

To Determine Eligibility for Program

1. Nature of business.
2. Number of years business has been in existence.

To Exclude Ineligible Employees

3. Status of employees (full time or part time).
4. Employment dates.
5. Current employment status (i.e., at work for prior 30 days).

To Prepare Individual Proposals

6. Names of employees.
7. Dates of birth.
8. Smoker/nonsmoker.
9. Salary schedule (if appropriate).

To Administer Program

10. Payroll dates.
11. Payroll cycle (weekly, biweekly, bifortnightly, or monthly).
12. Payroll clerk's name and telephone number.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 247. Life insurance premiums are deductible by corporation as additional compensation provided it has no ownership rights or beneficial interest in policy.

Q 252. Premiums paid by employer on policy owned by employee are taxable income to employee.

Q 324. Disability income benefits received from personally paid policy are tax-free.

Q 434. Within certain limits, benefits received from qualified long-term care policy are tax-free.

Footnotes

[1] Among the best prospects for salary allotment plans are existing group insurance clients. As to the employer, the tax treatment of salary allotment plans is similar to group insurance, in that the amounts paid for insurance are *deductible* (as a compensation expense). However, employee *after-tax* dollars are used to pay for the coverage.

[2] The terms "salary allotment," "salary deduction," and "payroll deduction" are interchangeable. In discussing this market, the terms "voluntary insurance" and "worksite marketing" are also used. If desired, there is no reason why an employer cannot contribute a portion of the premium. Contributions toward *life insurance* coverage are fully included in the employee's income. However, the employee may choose either to include or exclude employer contributions for *disability insurance* (see footnote 5, on page 251, and the table on page 326).

[3] The deduction of premium payments from payroll checks means that the employee will never have to sit down and write a check to the insurance company. A salary allotment plan provides an effective means by which the rank and file employee can set aside for emergencies or retirement some of the earnings projected in the table on page 318.

[4] Favorable enrollment conditions are required in order to obtain high levels of participation. Higher participation enables the insurance carrier to absorb increased losses, which often occur on account of underwriting concessions (i.e., guaranteed standard issue, simplified underwriting, etc.).

[5] Spouse and children riders are frequently available with life insurance offered in salary allotment plans. With disability insurance, the coverage will not necessarily offer level premiums, level benefits, and a guarantee of no policy cancellation. Annuity benefits would likely come from using accumulated life insurance cash values.

EXECUTIVE EQUITY

Executive equity, also known as a Section 162 Bonus Plan, is an employee benefit plan that allows an employer to provide valuable life insurance protection for a *selected* employee on a tax deductible basis to the employer.[1] The employer has total discretion to select the employee, or employees, to be covered by the agreement, and the amounts of insurance to be provided. It can be made available to both the stockholder-employee and the nonstockholder-employee.[2]

DURING LIFETIME. Under the agreement, the employee purchases and owns a permanent life insurance contract on his life.[3] The employer pays premiums to the insurance company, which are fully tax-deductible by the employer as compensation to the employee.[4]

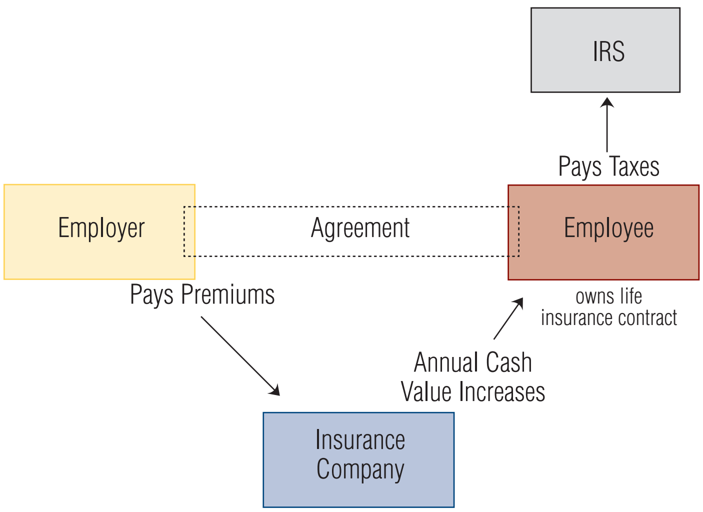
These premiums are considered taxable income to the employee, upon which the employee is responsible for paying taxes to the IRS.[5] However, the *employee owns* the life insurance contract, including all policy cash values, and the annual increase in these values may more than offset any taxes paid by the employee. If desired, these taxes could be paid with borrowed or withdrawn policy cash values, or dividends, if funded with a participating policy.[6]

UPON DEATH. At the employee's death, the insurance company pays the total death benefit directly to the employee's beneficiary. Because it is the death benefit of a life insurance contract, this payment is received free of all income taxes.

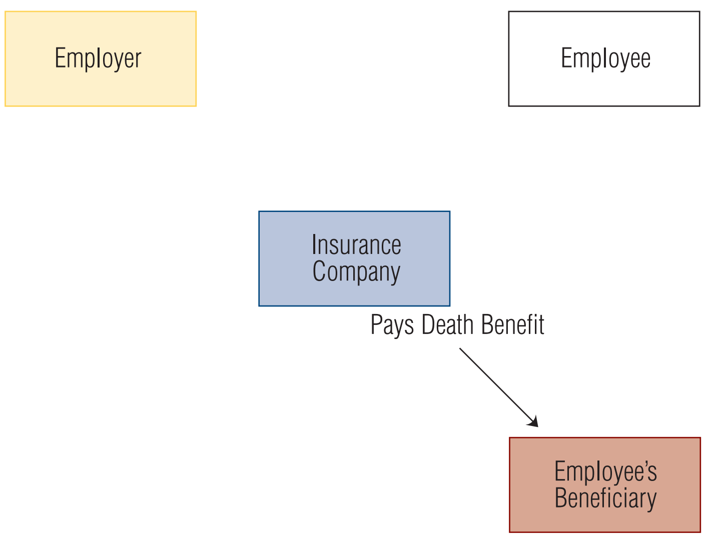
Executive equity offers something for everyone – tax deductibility to the employer, cash value accumulations for the employee, ease of installation, and premium payments with a business check.[7] If the employee-stockholder's marginal tax bracket is less than his corporation's marginal tax bracket, then executive equity should be attractive to the employee-stockholder who wishes to withdraw profits from the corporation.

Footnotes on page 219

DURING LIFETIME



UPON DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of employee.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Employee's tax bracket – to calculate taxes on bonuses (i.e., premium payments made for employee by employer).
6. Employer's tax bracket – to calculate after-tax cost of bonuses.
7. Projected bonuses or premiums to be paid by employer each year.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 245. General discussion of when premiums paid are either deductible or nondeductible.
Q 247. Life insurance premiums are deductible by corporation as additional compensation provided it has no ownership rights or beneficial interest in policy.
Q 252. Premiums paid by employer on policy owned by employee are taxable income to employee.
Q 255. Income tax consequences of Section 162 Bonus Plan.

Footnotes

1 Executive Equity plans are also referred to as "Executive Bonus Plans," "Executive Retirement Bonus Plans," and "Section 162 Bonus Plans" (after Section 162(a)(1) of the Internal Revenue Code, which authorizes a business to deduct a "reasonable allowance" for salaries or other compensation for personal services actually rendered).

2 If executive equity is to be effective with owner-employees, it must usually be used in a regular C corporation (not an S corporation). Neither the sole proprietorship nor the partnership provides the separate taxable entity that is essential for the concept to be an attractive benefit for owner-employees.

3 Because the contract is entirely owned by the employee, it is not essential that the agreement be in writing. However, it is good practice to have the terms of any important agreement in writing; and the agreement could help defend against an IRS attempt to characterize the bonuses as nondeductible dividends.

4 In 2015 married couples filing jointly with $230,450 or less of taxable income, and single taxpayers with $189,300 or less of taxable income, are in a 28 percent or lower tax bracket (see tax rates on page 585). For these individuals, executive equity is an attractive benefit (i.e., "enhanced" individual after-tax dollars are available to pay premiums, whereas a corporation with over $75,000 of taxable income is in a minimum 34 percent tax bracket).

5 The premiums paid by the employer are reported as "other compensation" on the employee's W-2 form. Likewise, this compensation is subject to both the Social Security Tax (FICA) and the Federal Unemployment Tax (FUTA). Underlying any discussion of employee benefits is the assumption that, if challenged by the Internal Revenue Service, the increased compensation would be considered "reasonable." For an expanded discussion of Unreasonable Compensation, see page 581.

6 In designing the column arrangements of executive equity illustrations, it is particularly important to emphasize the direct comparison between the yearly *income taxes* paid by the employee and the annual *cash value increases*, all of which are owned by the employee. For example, if the employer pays a premium of $2,500 for $100,000 of insurance protection, this $2,500 will constitute taxable income to the employee. Assuming in 2015 the employee is in a 25 percent tax bracket, he will have to pay $625 of additional income taxes (.25 × $2,500). However, if the cash values *owned* by the employee increased by $1,300 in that year, this more than offsets the taxes paid. The increase in cash surrender value is not taxable.

7 Note that with executive equity, the employer has no interest in either the cash values or the death benefits. This contrasts with a split-dollar arrangement, under which the employer usually owns most, if not all, of the cash values, and receives a portion of the death benefits. To better appreciate these differences, see the Split-Dollar Insurance chart on page 225 and the comparison of Executive Equity. The Restrictive Bonus Plan discussed in the chart on page 221 provides an interesting alternative to both Executive Equity and Split-Dollar plans.

RESTRICTIVE BONUS PLAN

The restrictive bonus plan is an employee benefit that allows an employer to provide valuable life insurance protection for a *selected* employee on a tax deductible basis to the employer.[1] The employer has total discretion to select the employee, or employees, to be covered by the agreement, and the amounts of insurance to be provided. It is typically made available to the nonstockholder-employee.

DURING LIFETIME. Under the agreement, the employee purchases and owns a permanent life insurance contract on his life. Added to the policy is a restrictive endorsement that requires the employer's consent for the employee to: (1) surrender the policy; (2) assign or pledge the policy for a loan; (3) change ownership of the policy; or (4) withdraw or borrow the cash values of the policy.[2] The endorsement will typically provide for these restrictions to expire upon the earliest to occur of: (1) the retirement of the employee; (2) attainment of a specific age; (3) a period of years; (4) release by the employer; or (5) the bankruptcy or dissolution of the employer.

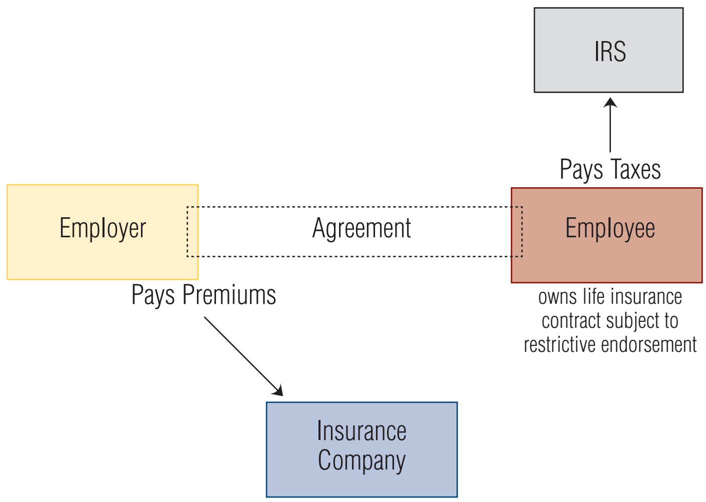
By *separate* written agreement, the employer agrees to provide a bonus to the employee by paying all premiums to the insurance company, which is fully tax-deductible by the employer as reasonable compensation to the employee.[3] These premiums are considered taxable income to the employee, upon which the employee is responsible for paying taxes to the IRS.[4]

UPON DEATH. At the employee's death, the insurance company pays the total death benefit directly to the employee's beneficiary. Because it is the death benefit of a life insurance contract, this payment is received free of all income taxes.[5]

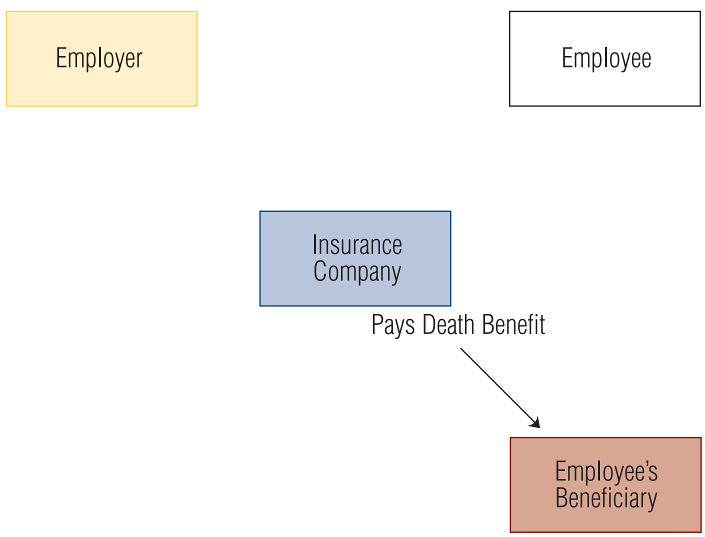
The restrictive bonus plan offers something for everyone – tax deductibility to the employer, a simple yet attractive "golden handcuff" for attracting and retaining a key employee, life insurance protection together with cash value accumulations available to the employee upon retirement, ease of installation, and premium payments with a business check.[6]

Footnotes on page 223

DURING LIFETIME



UPON DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of employee.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Employee's tax bracket – to calculate taxes on bonuses (i.e., premium payments made for employee by employer).
6. Employer's tax bracket – to calculate after-tax cost of bonuses.
7. Projected bonuses or premiums to be paid by employer each year.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 245. General discussion of when premiums paid are either deductible or nondeductible.
Q 247. Life insurance premiums are deductible by corporation as additional compensation, provided it has no ownership rights or beneficial interest in policy.
Q 252. Premiums paid by employer on policy owned by employee are taxable income to employee.

Footnotes

[1] The restrictive bonus plan is also referred to as a "Restrictive Endorsement Bonus Arrangement (REBA)," a "Golden Executive Bonus Arrangement (GEBA)" and a "Controlled Executive Bonus Plan."

[2] One objection to executive equity plans is that the employee can terminate employment at any time, yet have full access to the cash values of the life insurance contract (see chart, page 217). The restrictive bonus plan is an extension of the executive equity concept that in part answers this objection by giving the employer some measure of control over the employee's use and enjoyment of the policy (i.e., a "golden handcuff").

[3] If desired, a "double bonus" could be given (i.e., the bonus is large enough to pay not only the premium, but also the tax on the bonus). The premiums paid by the employer are reported as "other compensation" on the employee's W-2 form. Likewise, this compensation is subject to both the Social Security Tax (FICA) and the Federal Unemployment Tax (FUTA). Underlying any discussion of employee benefits is the assumption that, if challenged by the Internal Revenue Service, the increased compensation would be considered as "reasonable." For an expanded discussion of Unreasonable Compensation, see page 581.

[4] A more aggressive plan design requires the employee to reimburse the employer for some or all of the premiums paid, should the employee terminate employment prior to normal retirement date (or within a certain period of time). While the tax results of this reimbursement are not entirely clear, it seems likely the employee would not be allowed to deduct the repayment and the employer would be required to include the repayment in income. Also, see footnote 6 below regarding the need for the employee's interest to fully vest in order for the employer to get a current deduction for the premiums paid (i.e., not subject to a substantial risk of forfeiture, thus taxed on bonus).

[5] Note that with both the restrictive bonus plan and executive equity, the employer has no interest in either the cash values or the death benefits. This contrasts with a split-dollar arrangement, under which the employer usually owns most, if not all, of the cash values, and receives a portion of the death benefits.

[6] It is important that the employer have no interest in the life insurance contract, because Code section 264 would disallow the employer's tax deductions for the bonuses if the employer is directly or indirectly a beneficiary under the policy. It is also important to keep the written agreement entirely separate from the policy endorsement, particularly if the employer has a right to be reimbursed for bonuses given the employee. Code section 83 provides, in effect, that the employee is not taxed on property "transferred in connection with the performance of services," if the property: (1) is not transferable by the employee; *and* (2) is subject to a substantial risk of forfeiture. It is clear that the first condition is met since the endorsement prohibits the employee from transferring the policy. Therefore, if the second condition is met, the employee is not taxed and the employer cannot take a current tax deduction. However, most authorities agree that there is no substantial risk of forfeiture if the employer has no interest in the policy and employee's agreement to repay bonuses is nothing more than a bare promise set forth in a separate agreement.

SPLIT-DOLLAR INSURANCE

Split-dollar insurance is an agreement between two parties to *allocate* between them the costs and benefits of a life insurance policy.[1] It is *not* a particular type of life insurance policy. When adopted by an employer split-dollar insurance allows the employer to provide valuable life insurance protection for *selected* employees.[2]

Under regulations issued by the IRS there are two ways for an employer to establish a new split-dollar plan.[3]

(1) **Loan regime.** Under this method the *employee* purchases and is the owner of a life insurance contract. The employee-purchased policy is then collateral assigned to the employer to secure employer premium payments. Each employer premium payment is treated as a loan from the employer to the employee. The employee will either: (a) pay to the employer a market rate of interest on these loans; or (b) receive additional compensation equal to the foregone interest.[4]

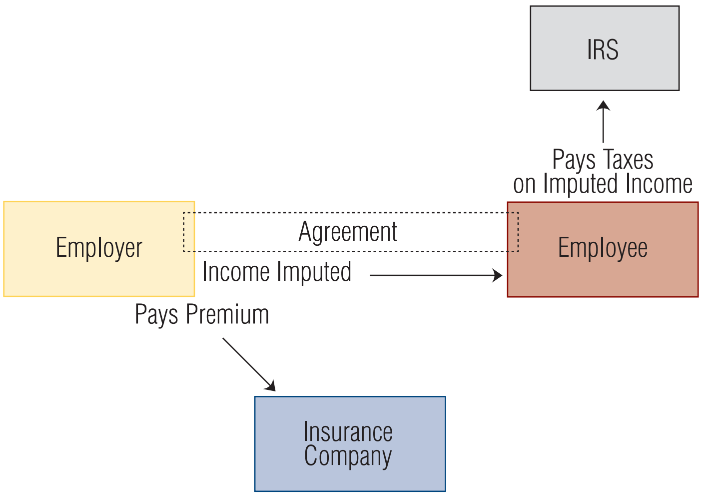
(2) **Economic benefit regime.** This method offers a straightforward means of providing to the employee a supplemental executive life insurance death benefit during the years prior to retirement. It is often implemented as follows:

DURING LIFETIME. The *employer* purchases and owns a permanent life insurance policy insuring the employee's life.[5] Pursuant to the split-dollar agreement the employer typically pays the entire premium (an "employer pay all" plan) and owns all cash values.[6] Each year income is imputed to the employee in an amount equal to the "economic benefit" of the insurance protection received by the employee.[7] The employee is responsible for paying taxes to the IRS on this imputed income. There are no tax deductions to the employer (i.e., income imputed to the employee cannot be deducted by the employer). However, provided it is reasonable compensation, the employer could consider paying a bonus to assist the employee in paying taxes on the imputed income.

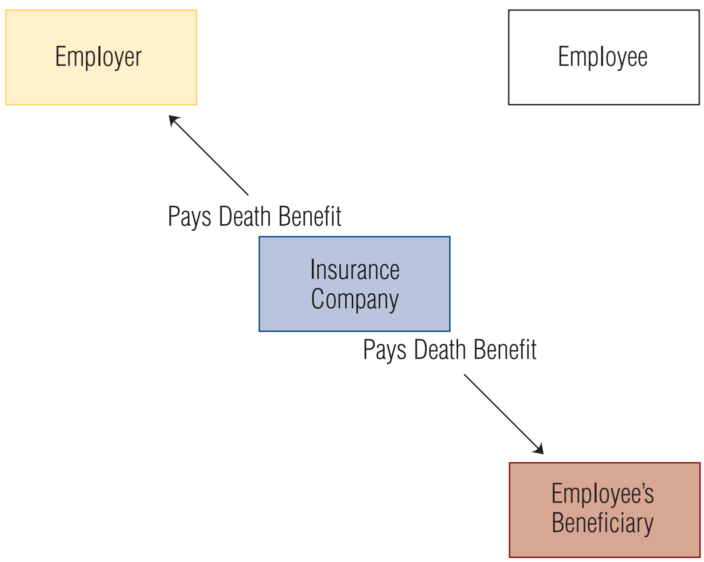
UPON DEATH. The death benefit payable to the employer can vary according to the provisions of the split-dollar agreement. Typically, the employer is entitled to a death benefit equal to the *greater* of the cash values or the cumulative premiums paid. By endorsement to the policy the employee's personal beneficiary is entitled to the death benefits in excess of the amount paid to the employer.[8]

Footnotes on page 227

DURING LIFETIME



UPON DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of employee.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Amount of desired death benefit.

To Design Plan

6. Position of employee.
7. Is the employee a stockholder?
8. Purpose of the employee's insurance need – family income, estate liquidity, etc. (i.e., how long is the death benefit needed?).
9. Employee's tax bracket – to calculate employee's after-tax cost of imputed income.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 111. Gift taxation of split-dollar.
Q 308. Estate taxation of split-dollar.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3898. Description of split-dollar.
Q 3899. Income tax results of traditional split-dollar plan.
Q 3903. Treatment of split-dollar plans under final regulations.
Q 3904. Income tax consequences of transfer or "rollout" of split-dollar policy.
Q 3906. Description of private split-dollar and how it is taxed.

Footnotes

[1] The split-dollar plan described in this chart is intended to comply with the requirements of the final split-dollar regulations (effective for plans established after September 17, 2003). Given that the employer pays *all* life insurance premiums and is entitled to *all* cash values, it is better to use the word "allocate" rather than the word "share" (i.e., the premiums and the cash values are allocated to the employer, they are not shared with the employee). See tables A and B on pages 301-302 concerning the treatment of Employer/Employee Split-Dollar Plans established on and before September 17, 2003.

[2] Split-dollar insurance can be provided for the employees of a corporation, a partnership, or a sole proprietorship (sole proprietors cannot be covered because there is no separate taxable entity). Split-dollar is generally not appropriate for partners or employee-stockholders of S corporations because of the pass-through nature of taxation (except to reallocate premiums among owners and when used with a life insurance trust to reduce the value of gifts to the trust, see footnote 5, page 235, and pages 539-541). In contrast, Private Split-Dollar involves an agreement between individuals, or between an individual and a trust (see chart on page 63).

[3] Based upon policy ownership the split-dollar regulations use a formalistic, yet straight forward, approach in providing two "mutually exclusive regimes" (or methods) for the taxation of split-dollar plans. The **economic benefit regime** which is illustrated in this chart (as in the typical endorsement arrangement) applies where the employer owns the contract. The **loan regime** (as in the typical collateral assignment arrangement) applies where the employee owns the contract. However, as an exception to the general rule, even if the employee owns the contract the split-dollar plan is subject to the economic benefit regime if all cash values belong to the employer. This is useful in majority stockholder situations when it is desired to remove all employer death benefits from the insured's estate (see the discussion of Controlling Stockholder on page 362).

[4] In contrast to the chart on page 225 illustrating a split-dollar plan under the economic benefit regime, see the chart on page 395 illustrating a split-dollar plan under the loan regime (the "during lifetime" portion of the chart looks quite different). See also the discussion of Equity Split-Dollar on pages 393-396 for an explanation of the complicated tax treatment of imputed loans.

[5] If the employer could receive a death benefit in excess of cumulative premiums paid it is essential to meet strict notice and consent requirements to preserve the employer's income tax-free death benefit (see Company Owned Life Insurance (COLI), pages 357-359).

[6] These employer-owned cash values can be used to informally fund a nonqualified deferred compensation plan (see chart, page 241). Under the economic benefit regime any direct or indirect access to the cash values is immediately taxable to the employee-nonowner, who cannot obtain any income tax basis in a policy owned by the employer (meaning equity endorsement plans will rarely be adopted). Also, the employee does not share in the premium payments, since under the split-dollar regulations any premiums paid by the *employee* under the economic benefit regime are considered taxable income to the *employer* (under the theory that the employee is paying premiums on a contract owned by the employer). This means that the old "single bonus" plan no longer offers any advantage since this taxable income offsets the employer's deduction for the bonus given the employee.

[7] Under the regulations this "economic benefit" is measured by "life insurance premium factors" to be published by the IRS. Until these factors become available, the Table 2001 rates on page 588 are permissible. Failure of the employee to report this economic benefit, or to contribute an equal amount of premiums, will result in the death benefits being taxed as ordinary income to his beneficiary (i.e., they will not qualify as tax-free life insurance death benefits). Assuming the employee will live to normal retirement age or beyond the taxable economic benefit will get very expensive. This means that an "exit strategy" must be in place if the employee's death benefit is to be maintained after retirement (see Split-Dollar Rollout, page 558).

[8] Provided the employer is willing to have no interest in either the cash values or the death benefit, Executive Equity offers a simpler approach to obtaining needed life insurance protection. It is easier to install, in that there is no required formal agreement between the employer and the employee (see chart, page 217). The Restrictive Bonus Plan in the chart on page 221 provides an interesting alternative.

SPLIT-DOLLAR FUNDING CROSS PURCHASE

Split-dollar insurance is not limited to merely funding the personal insurance needs of an employee. For example, the employee could choose to enter into a split-dollar agreement insuring someone other than himself, such as a spouse or a child. Alternatively, the employee could choose to enter into a split-dollar agreement insuring another stockholder whose stock he is obligated to purchase.[1]

DURING LIFETIME. Assume that we have a corporation owned by two individuals, Employee A and Employee B. They enter into a cross-purchase agreement providing for the purchase and sale of their respective interests.[2]

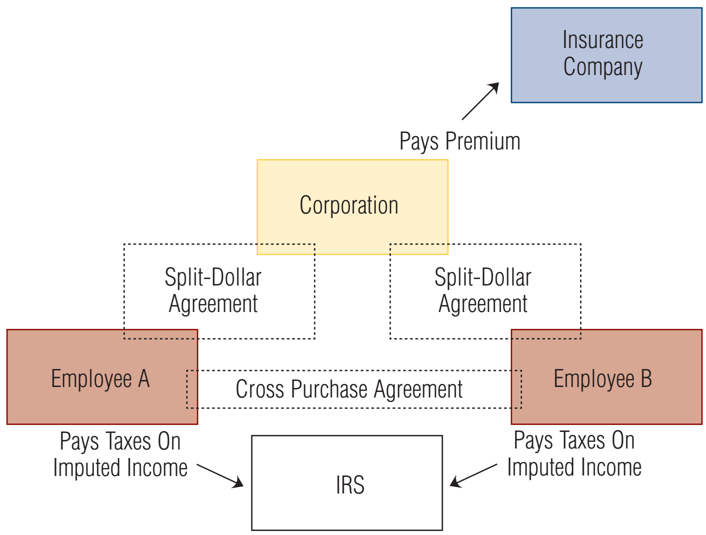
The *corporation* purchases and owns a permanent life insurance policy insuring the life of each employee.[3] In order to fund their mutual obligations to each other, A and B enter into split-dollar agreements with the corporation providing for the allocation of premiums, cash values and death benefits. In contrast to the typical employer/employee split-dollar plan that provides death benefits for the insured's personal beneficiary, these agreements provide for A to receive the death proceeds from the policy insuring B, and for B to receive the death proceeds from the policy insuring A.[4]

The corporation typically pays the entire premium for each policy ("employer pay all" plans) and owns all cash values.[5] Each year income is imputed to the employee in an amount equal to the "economic benefit" of the insurance protection received by the employee on the life of the other employee.[6] Rather than having to come up with expensive after-tax dollars to pay premiums, A and B pay taxes to the IRS on only this imputed income.[7]

UPON DEATH. Assuming that A dies first, his stock interest would then pass to his family or estate. At the same time, the insurance company pays a portion of the death benefit to the corporation to reimburse it under the terms of the split-dollar agreement. The remainder of the death benefit is paid income tax-free to B, which is then used by B to purchase A's entire stock interest from A's family or estate.[8]

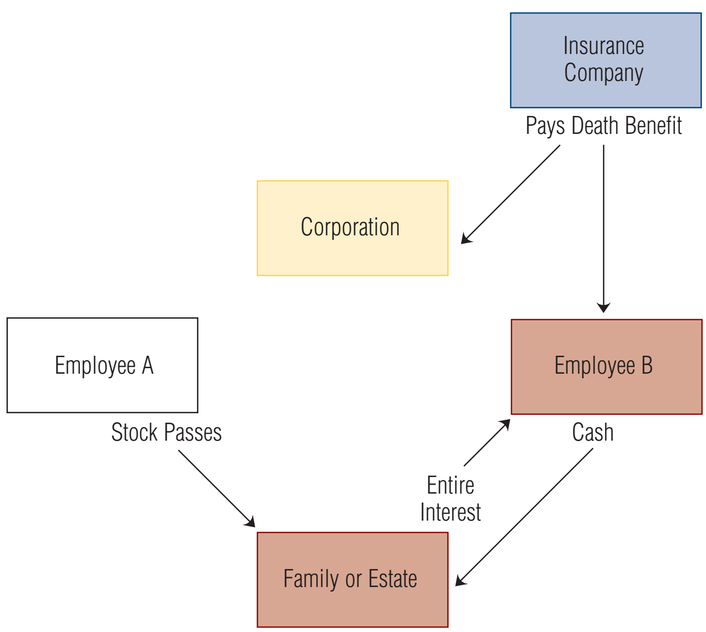
Footnotes on page 231

DURING LIFETIME



Corporation Obtains Life Insurance On Each Employee

UPON DEATH



Split-Dollar Funding Cross Purchase

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of stockholder to be insured.
2. Sex.
3. Date of birth.
4. Value of ownership interest.
5. Employee's tax bracket – to calculate employee's after-tax cost of imputed income.

Note: The "employee's tax bracket" is that of the employee who is entering into the split-dollar agreement with the corporation, *not* the tax bracket of the employee-stockholder who is the insured.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Cross Purchase

Q 283. Sale of deceased's stock will usually not result in income tax liability to deceased's estate.

Q 284. Income tax effects of funding stock purchase agreement with life insurance.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Split-Dollar

Q 3898. Description of split-dollar.

Q 3899. Income tax results of traditional split-dollar plan.

Q 3904. Income tax consequences of transfer or "rollout" of split-dollar policy.

Footnotes

[1] In working with a business client it is important to remember that it is usually far easier to obtain payment of premiums with the *corporate* check than the *personal* check. Split-dollar enables employee-stockholders to use a corporate check to pay for life insurance to fund their cross purchase agreement. (Where there is a disparity in ages between the insureds, split-dollar can also help to de-emphasize the difference because substantial portions of the premiums are paid with corporate dollars.) To fund a cross purchase agreement between employee-stockholders, in some situations executive equity may offer a simpler solution, provided there is no requirement that the corporation have any interest in either the cash values or the death benefits (see the Executive Equity chart, page 217).

[2] See the Cross Purchase Agreement chart, page 135. To be viable, split-dollar usually requires that the employer and employee each be a separate taxable entity. Therefore, other than situations where split-dollar is being used primarily for estate and gift tax leverage, funding a cross purchase agreement between two owners of a business is generally limited to a regular C corporation, and would *not* be applicable to an S corporation or a partnership. However, it would be feasible to use split-dollar to fund a *key employee* purchase of a stockholder's interest in a corporation, a partnership, or even a sole proprietorship, since in each of these situations the key employee represents a separate taxpayer from his employer (see the Key Person Buy-Out Agreement chart, page 151).

[3] The corporation's ownership of the policy under an endorsement split-dollar plan (see footnote 5, below) could result in a prohibited "transfer for value" if the policy is subsequently transferred to a co-stockholder (e.g., the split-dollar arrangement is terminated and the policy is transferred to a co-stockholder to fund an ongoing cross purchase obligation). This problem only occurs if the transfer does not fit within any of the transfer for value exceptions (see the expanded discussion on page 573). If it is considered important to avoid this *latent* transfer for value problem, the split-dollar agreement could be implemented using the loan regime (i.e., the policy is *owned by the co-stockholder* who collaterally assigns the cash values to the corporation, see the expanded discussion on pages 394-395).

[4] If there is any possibility that the employer could receive a death benefit in excess of cumulative premiums paid, it is essential to meet strict notice and consent requirements to preserve the employer's income tax-free death benefit (see Company Owned Life Insurance (COLI), pages 357-359).

[5] Under the split-dollar regulations this is a "nonequity endorsement plan" intended to be taxed under the economic benefit regime (see the Split-Dollar Insurance chart, page 225). Under the economic benefit regime any direct or indirect access to the cash values is immediately taxable to the employee-nonowner (see also footnote 6, page 227). However, these employer-owned cash values could be used to informally fund a nonqualified deferred compensation plan (see the Deferred Compensation chart, page 241).

[6] Note that the life used to measure the "economic benefit" is that of the insured co-stockholder, not the employee-stockholder who enters into the split-dollar agreement with the corporation. Under the regulations this "economic benefit" is measured by "life insurance premium factors" to be published by the IRS. Until these factors become available, the insurance company cost of annual renewable term insurance or the Table 2001 rates on page 588 are permissible. Use of the insurance company term rates is subject to a number of IRS requirements – some of which are not well defined.

[7] The typical corporate split-dollar agreement involving an employee/stockholder is intended to provide an *employee benefit*, not a stockholder benefit. However, lowered maximum tax rates on qualified corporate dividends (permanently reduced by the American Taxpayer Relief Act of 2012 to 0 percent, 15 percent, and 20 percent after 2012 may cause some split-dollar agreements to be established as stockholder plans, with the stockholder's imputed income taxed at these lower dividend tax rates. Of course, any imputed dividends would not be deductible by the corporation.

[8] Failure of the employee to report this economic benefit, or to contribute an equal amount of premiums, will result in the death benefits being taxed as ordinary income (i.e., they will not qualify as tax-free life insurance death benefits).

SPLIT-DOLLAR FUNDING LIFE INSURANCE TRUST

Split-dollar offers a means of using employer-provided dollars to pay premiums for life insurance used for a variety of purposes, to include family income needs, estate taxes, and other estate settlement costs. When combined with an irrevocable life insurance trust, it is possible to take advantage of the gift tax laws while at the same time assuring that the proceeds will be received free of estate taxes.[1]

These plans will likely be structured as: (1) an "equity collateral assignment plan" using a trust-owned policy with employer-paid premiums treated as loans to the employee under the *loan regime* (cash values owned by the trust but assigned to the employer as security for the loans) or (2) a "nonequity collateral assignment" plan using a trust-owned policy with the employee taxed under the *economic benefit regime* (employer entitled to all cash values).[2] This last design offers the most flexibility and can be implemented as follows:[3]

DURING LIFETIME, the employee establishes a trust and the trustee applies for, or obtains, insurance on the employee's life.[4] Thereafter, at the employee's request, the employer and trustee enter into a split-dollar agreement providing for the allocation of premiums, cash values, and death benefits on the trust-owned insurance policy.[5] Under this agreement the employer pays all premiums and is entitled to all cash values (by virtue of a limited collateral assignment from the trust).[6]

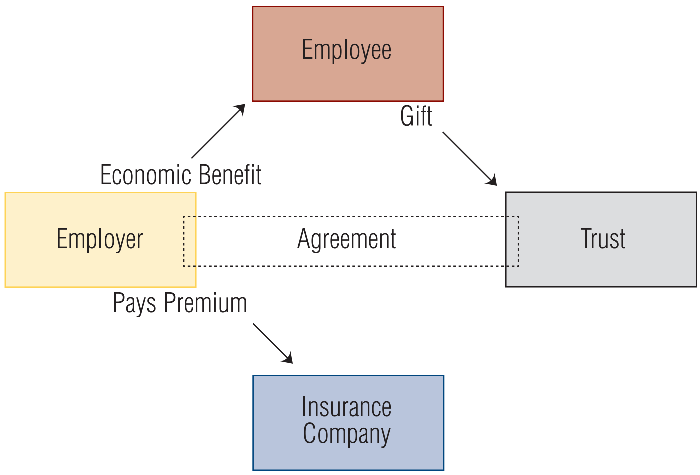
Each year *income* is imputed to the employee in an amount equal to the "economic benefit" of the insurance protection received by the trust.[7] This same amount is then imputed as a *gift* by the employee to the trust. Provided the trust is properly funded, and the beneficiaries given appropriate withdrawal powers, these imputed gifts will qualify for the gift tax annual exclusion of $14,000 in 2015.[8] Of course, it is unlikely that they would exercise these powers, since to do so would defeat the purpose of the trust.

UPON DEATH of the employee, the policy proceeds are split between the employer and the trust. The employer is entitled to a death benefit equal to the *greater of* the cash values or the cumulative premiums paid. Under the split-dollar agreement the balance of the proceeds are paid directly to the trust and are both income and estate tax free.[9] The funds are then available to be used or disbursed by the trustee pursuant to the trust provisions, which could include purchase of estate assets, loans to the estate or others, payment of income to beneficiaries, and eventual distribution of trust corpus to beneficiaries.

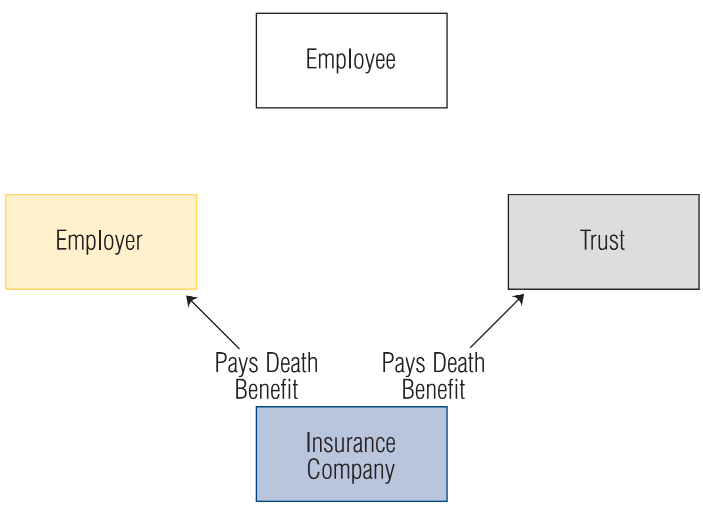
Footnotes on page 235

Split-Dollar Funding Life Insurance Trust

DURING LIFETIME



UPON DEATH



Split-Dollar Funding Life Insurance Trust

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual or individuals to be insured.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Amount of desired death benefit.

To Design Split-Dollar Plan

6. Position of employee.
7. Is employee a stockholder?

Attorney Drafting Trust Instrument Must Also Know

8. Trustee during insured's lifetime.
9. Trustee after insured's death.
10. Names of beneficiaries.
11. Ages of minor beneficiaries.
12. To who, in what amount, and when trust income is to be paid.
13. To who, in what amount, and when trust corpus is to be paid.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Income Tax

Q 148. Death proceeds received by trust free of income taxes.

Estate Tax

Q 174. When proceeds either included or excluded from insured's estate.
Q 308. Estate taxation of split-dollar.

Gift Tax

Q 111. Gift taxation of split-dollar.
Q 154. Qualification for annual gift tax exclusion.
Q 156. Qualification for annual gift tax exclusion when gifts made to trust for premium payments (Crummey rules).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (~~2014~~)

Q 3898. Description of split-dollar.
Q 3989. Income tax results of traditional split-dollar plan.
Q 3904. Income tax consequences of transfer or "rollout" of split-dollar policy.

See also cross references to life insurance trusts on page 52.

Footnotes

[1] If the insured is a majority stockholder the corporation can have no ownership interest in the policy if it is desired to remove the death benefits from his estate. It is important that the corporation not own the policy and have only a *limited* collateral assignment (see discussion, page 362).

[2] These regimes, or methods, are set forth in IRS regulations and are used to determine the tax treatment of *new* split-dollar plans (see Table C on page 303). Regarding the treatment of split-dollar plans established on or before September 17, 2003, see Tables A and B on pages 301-302.

[3] As an insured grows older the endorsement and nonequity collateral assignment plans taxed under the economic benefit regime become costly to maintain. This is due to the increasing "economic benefit" amount that is imputed as income to the employee and a gift to the trust. For example, using Table 2001 rates, $1,000,000 of insurance is valued at only $1,530/year for a male age 45, but this increases to $11,900/year for a male age 65, and to $88,760/year for a male age 85 (see table, page 588). When there is a permanent need for life insurance coverage, it is important to build flexibility into the split dollar plan to assure some means of maintaining the policy (often described as an "exit strategy"). For example, a *nonequity* collateral assignment plan, taxed under the economic benefit regime, might be converted to an *equity* collateral assignment plan, and taxed under the loan regime (i.e. at older ages reporting or paying loan interest costs less than paying income and gift taxes on imputed economic benefit.) See the discussion of Equity Split-Dollar on pages 393-396. However, if the conversion occurs after the accrual of policy cash values in excess of the trust's basis, this equity will be taxable income to the employee and a gift to the trust. Other exit strategies providing for a *termination* of the split-dollar plan should also be considered (see footnote 6, below).

[4] In a family-owned business it is possible that the reach of the attribution rules under new Code section 101(j) *might* treat this policy as "employer-owned." This could subject the death benefits to income taxation. To assure the proceeds are received free of income taxes, appropriate notice and consent should be obtained (see Company Owned Life Insurance (COLI) pages 357-359).

[5] When large amounts of insurance are required on older individuals, the premium requirements can often exceed the annual exclusion limits for present interest gifts (see footnote 4, page 53, and page 368). Split-dollar funding survivorship life insurance payable at the second death can substantially reduce the annual gifts to the trust, thereby allowing larger amounts of insurance to be purchased within these "present interest" limits (see Survivorship Life Insurance, page 566).

[6] If the split-dollar agreement is terminated and the employer releases the trust's assignment of cash values under a split-dollar "rollout," all cash values would then be owned by the trust. This release of employer-owned cash values would be treated as both taxable income to the employee and a gift by the employee to the trust (see Split-Dollar Rollout, page 558).

[7] Under the regulations this "economic benefit" is measured by "life insurance premium factors" to be published by the IRS. Until these factors become available the Table 2001 rates on page 588 should be permissible.

[8] Note that gifts to the trust are *imputed;* funds are not actually transferred to the trust. Also, unlike the typical life insurance trust, the trustee does not have any ownership interest in the policy cash values (see Life Insurance Trust chart, page 51). To qualify for the annual gift tax exclusion the trust beneficiaries must actually have an opportunity to withdraw funds from the trust. Partial funding of the trust with other liquid assets would allow the trustee to satisfy potential present interest demands of trust beneficiaries. See page 268 for a discussion of these withdrawal rights, which are often referred to as "Crummey" powers.

[9] Failure of the employee to report this economic benefit, or to contribute an equal amount of premiums, will result in the death benefits being taxed as ordinary income to his beneficiary (i.e., they will not qualify as income tax-free life insurance death benefits).

SURVIVOR INCOME

The sudden loss of income at the death of a breadwinner can be devastating to a surviving family.[1] A survivor income plan can assure that continuing income will be available and is based upon a written agreement between the employer and the employee.

Benefits under such a plan usually take the form of ongoing and periodic payments for a specified number of years following the employee's death. Typically, such benefits are set as a percentage of final pay for a period of years. For example, the plan may provide for 50 percent of final pay, per year, for 10 years.[2]

DURING LIFETIME, the employer and employee enter into an agreement providing for the employer to make periodic payments to the employee's beneficiary following the employee's death. In order to provide the funds to meet its obligation, the employer purchases a life insurance contract insuring the employee.[3] Neither the employee nor his family has any rights whatsoever in this policy. Because the employer is both owner and beneficiary of this contract, the premium payments are not tax-deductible to the employer. Nor will the premiums be taxable to the employee provided the contract is clearly not tied to the promise to pay the survivor benefit. In this sense, the contract is carried in the same manner as key person insurance, the difference being the *purpose* for which the death benefit will be used.

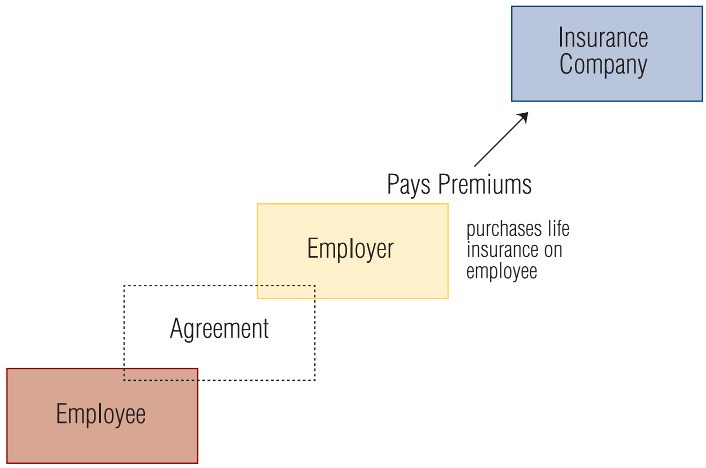
UPON DEATH, the insurance company pays a death benefit directly to the employer, as beneficiary of the contract insuring the employee.[4] Under the pre-existing agreement, the employer then provides a survivor income benefit to the family. While these payments are fully tax-deductible by the employer, they will be received as taxable income by the family.

Using life insurance to help meet the obligation under a survivor income plan offers tax-leverage to the employer, in that *receipt* of the death benefit by the employer is potentially tax-free, whereas *payments* made to the surviving family are fully tax-deductible. For an employer in a 34 percent marginal tax bracket, payment of $1.00 in benefits will generate a tax savings of 34 cents.[5]

The *insured* survivor income plan provides the security of continuing income to the employee's family, while offering tax-leverage to the employer.[6]

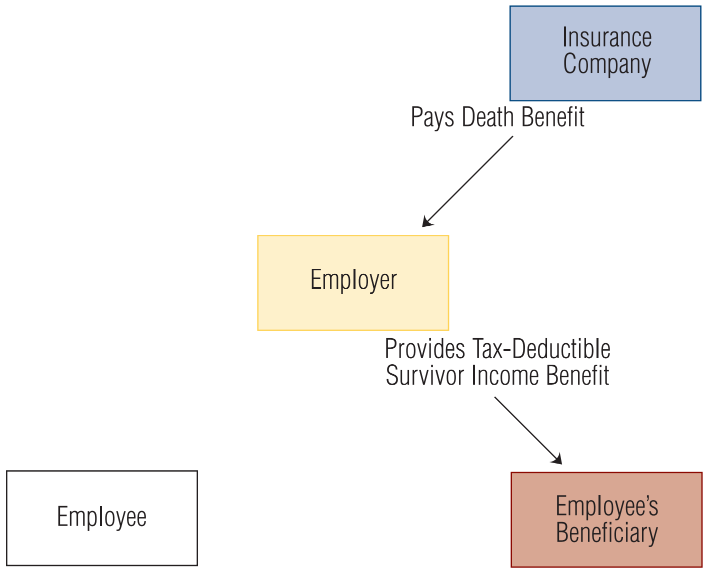
Footnotes on page 239

DURING LIFETIME



Agreement Provides For Periodic Payments Following Employee's Death

UPON DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of employee.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Employer's tax bracket.
6. Amount of insurance coverage.
7. Method of payment to surviving family (lump-sum, period certain, annuity purchase, etc.).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Income Tax

Q 250. Premiums paid by corporation not taxable to insured employee (provided corporation is owner and beneficiary).

Q 252. Uncertain tax results if family is named as revocable beneficiary of life insurance contract.

Q 276. Proceeds paid to widow are taxable as compensation for past services of deceased employee.

Estate Tax

Q 95. Estate tax treatment when only benefit is survivor income.

Q 96. Estate tax treatment when employee has no rights to income (death benefit only plan).

Gift Tax

Q 113. Gift tax treatment of survivor income benefit.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3599. Taxation of contractual death benefits to surviving spouse.

Q 3600. Employer's deduction of survivor income payments.

Footnotes

[1] ~~To better appreciate the total amount of future income lost when a bread winner dies, refer to the table of Projected Earnings on page 318. Human Life Value is also dealt with in the table Life Insurance Needs As a Percentage Of Earnings on page 16. While many surviving families can expect to receive benefits from Social Security, it is probably not advisable for them to rely on the system for the greater part of their financial security. For example, in 2014 the *maximum* monthly survivor's benefits available under Social Security are:~~

~~Age of Worker~~	~~Surviving Spouse & 1 Child; or 2 Children~~	~~Surviving Spouse & 2 Children; or 3 Children~~	~~One Child (no parent)~~	~~Widow Age 60~~	~~or~~	~~Widower Age 66~~
~~25~~	~~4,112~~	~~4,797~~	~~2,056~~	~~1,960~~		~~2,741~~
~~30~~	~~4,103~~	~~4,787~~	~~2,051~~	~~1,956~~		~~2,735~~
~~35~~	~~4,052~~	~~4,727~~	~~2,026~~	~~1,931~~		~~2,701~~
~~40~~	~~4,040~~	~~4,713~~	~~2,020~~	~~1,925~~		~~2,693~~
~~45~~	~~4,022~~	~~4,692~~	~~2,011~~	~~1,917~~		~~2,681~~
~~50~~	~~4,077~~	~~4,675~~	~~2,003~~	~~1,910~~		~~2,671~~
~~55~~	~~3,990~~	~~4,655~~	~~1,995~~	~~1,902~~		~~2,660~~
~~60~~	~~3,939~~	~~4,596~~	~~1,970~~	~~1,878~~		~~2,626~~

~~The above table has been extracted from Social Security Table 11, *Social Security & Medicare Facts* (National Underwriter Company). Note that a surviving family is entitled to payments provided one or more children are under age 16. Once all children are 16 or over, no Social Security benefits are available until the surviving spouse is age 60. This period between the youngest child's age 16 and spouse's age 60 is often referred to as the Social Security "blackout period."~~

[2] Although a lump-sum payment could be made, it is usually preferable to provide the family with an income stream more suited to its needs. This will also allow for spreading out of the family's income tax liability and the employer's tax deductions.

[3] Employer-owned life insurance must meet strict notice and consent requirements if the death benefits are to be received free of income taxes (see Company Owned Life Insurance (COLI), pages 357-359).

[4] Under some circumstances the corporate alternative minimum tax could result in the indirect taxation of life insurance proceeds received by a corporation (see pages 363-365).

[5] For each $1.00 received as a tax-free death benefit by the employer, this employer could afford to pay $1.52 in benefits. The calculations are as follows:

Desired After-Tax Cost	$ 1.00
Reciprocal Of Tax Bracket	÷ .66
Tax-Deductible Payment To Family	$ 1.52
Less Taxes Saved (34% tax bracket)	(.52)
After-Tax Cost	$ 1.00
Less Tax-Free Death Benefit	(1.00)
Cost To Make Payment	$ 0.00

Alternatively, the employer might prefer a return of all premiums, *plus* a tax-free gain to corporate surplus. For example, assume the tax-free death benefit from a $100,000 policy was invested in tax-free 6.6 percent municipal bonds. The employer could then afford to pay a survivor $10,000 per year for life, and eventually receive a return of all premiums and a tax-free gain. The yearly after-tax cost of the $10,000 payment would be covered by the $6,600 of tax-free income ($100,000 × .066). Of course, the above calculations would have to be adjusted downward if the death proceeds were subject to the corporate alternative minimum tax (see page 363-365).

[6] "Death benefit only" plans allow payments from a survivor income plan to be excluded from the employee's federal taxable estate (see Death Benefit Only plan on page 369).

DEFERRED COMPENSATION

In allowing *selected* management or highly compensated employees to defer income until after retirement, deferred compensation offers *multiple tax advantages* to both the employer and the participant.[1]

CORPORATE OBLIGATION. To illustrate, assume we have a key corporate manager who is currently age 45. Under its terms, the plan would provide for retirement payments, at age 65, of $10,000 per year for 10 years.[2] These payments would be *tax-deductible* to the corporation when made, and, although *taxable* to the retired employee, presumably he would pay less in taxes due to a reduced retirement income and resulting lower marginal tax bracket.

Typically, such plans also provide for survivor payments if the employee dies prior to retirement. For example, should the employee die at age 55, a typical plan might pay his surviving family $10,000 per year for 10 years. Since these payments would be tax-deductible to the corporation, each $10,000 payment would cost only $6,600 (assuming a 34 percent corporate marginal tax bracket). However, these payments would be taxable income to the family.[3] Life insurance cash values grow on an income tax deferred basis and death benefits are ordinarily received on an income tax free basis – making life insurance a common and tax-effective method of funding deferred compensation obligations.

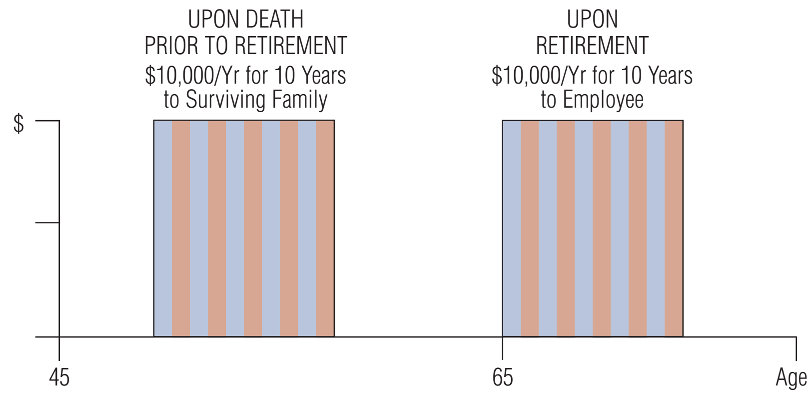
The plan can also be structured to provide disability benefits to the employee. To assure itself of funds to meet its obligation, the employer could purchase a disability income contract, or it could *partially* protect itself by adding a waiver of premium rider to any life insurance contract on the employee's life.[4]

LIFE INSURANCE on the employee can assure the employer that it will have the funds to meet its obligation.[5] For illustrative purposes, using life insurance for this purpose could require a corporate commitment to spend $4,000 per year during the first 20 years, and $6,600 per year during the 10 years following the employee's retirement (all after taxes).[6] The *cumulative* outlay by the corporation would be $80,000 during the 20 years prior to retirement at age 65, and $146,000 by time the employee reaches age 75.[7]

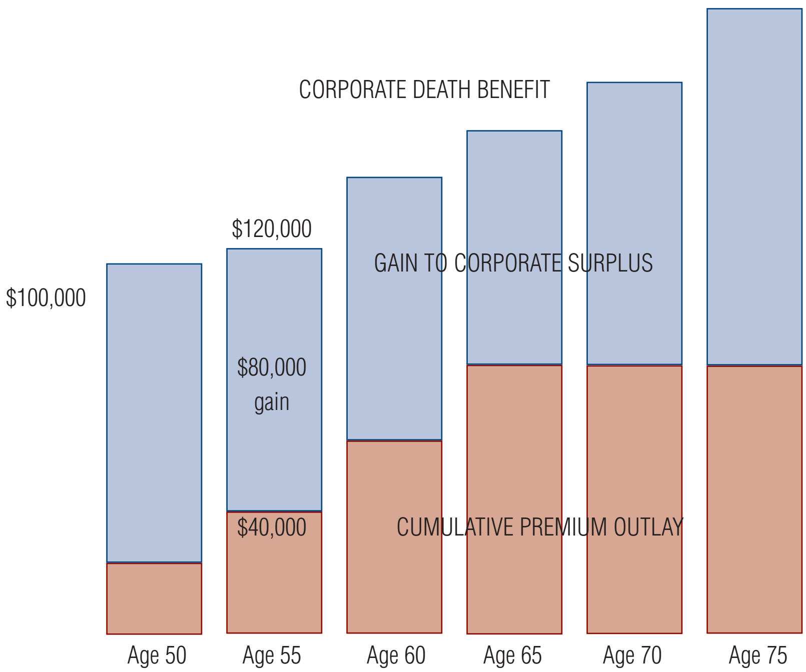
If life insurance with an increasing death benefit is purchased, it will likely produce a *gain* to corporate surplus when the employee dies, which amount can then be used to make the survivor payments. This gain is the amount by which the death benefit *exceeds* the cumulative outlay by the corporation (i.e., the sum of the premium payments prior to retirement and the after-tax cost of the retirement payments). For example, if the employee died at age 55, payment of a $120,000 death benefit would produce a gain to corporate surplus of $80,000 ($120,000 – $40,000 = $80,000).[8]

Footnotes on page 243

CORPORATE OBLIGATION



LIFE INSURANCE FUNDING



ASSUMPTIONS

Current Age 45 - Premium Outlay $4,000/year for 20 Years
Insurance Contract Provides Increasing Death Benefit
Retirement Outlay $10,000/year for 10 Years Beginning at Age 65
After-Tax Cost of Retirement Outlay is $6,600/year
(34% Tax Bracket)

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of executive.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Retirement age.
6. Retirement benefit or amount of contribution.
7. Method of payment for pre-retirement death benefit (lump-sum, period certain, annuity purchase, etc.).
8. Employer's tax bracket.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Estate Tax

Q 96. Inclusion of survivor benefit in employee's gross estate.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Income Tax

Q 3526. Discussion of income tax consequences of a "secular" trust.
Q 3532. Tax benefits of informally funded deferred compensation.
Q 3533. General requirements for deferred compensation.
Q 3535. Requirements that must be met under Section 409A.
Q 3553. Discussion of "economic benefit" theory.
Q 3554. Discussion of informal funding and other security devices in connection with deferred compensation.
Q 3556-Q 3558. Discussion of the "rabbi" trust.
Q 3560. When the employer can take deductions for deferred compensation.
Q 3561. How payments of deferred compensation are taxed when received by employee or beneficiary.
Q 3562. When deferred compensation contributions and benefits are subject to social security and federal unemployment taxes.

Footnotes

[1] The corporate owner who is also an employee will find many planning opportunities with deferred compensation that are not subject to the rules of "qualified" retirement plans. For example: (1) deferred reasonable compensation payments to a retired employee-stockholder are deductible to the corporation, whereas inflated payments for stock are not deductible; (2) the cash values of a life insurance contract, carried on the books and intended for deferred compensation, are usually considered to be for the reasonable needs of the business and thus immune from the accumulated earnings tax; (3) the liability for deferred payments to a surviving widow can have the effect of depressing the value of a deceased's stock for estate tax purposes; and (4) corporate owned cash values under a split-dollar arrangement can be used to provide the employer with funds to make deferred compensation payments.

[2] There are two types of deferred compensation plans: "pure" deferred compensation plans and salary continuation plans. Under a pure deferred compensation plan, the employee agrees to defer receipt of some portion of his present compensation. This deferral of compensation is not currently taxable to the employee, provided it is subject to a substantial risk of forfeiture (see the discussion of Section 409A on page 546 and Constructive Receipt on page 360). Under a salary continuation plan, the employer provides a benefit in addition to all other forms of compensation (i.e., there is no reduction in the employee's present compensation). When used with a vesting schedule or a non-competition agreement, a deferred compensation plan provides the "golden handcuffs" to retain a valued employee.

[3] Benefits paid to survivors are generally not subject to FICA and FUTA taxes. However, these taxes can be currently imposed upon participants if the plan provides nonforfeitable benefits. This will not be too great a problem for the executive whose other wages exceed the OASDI wage base.

[4] Backing up the plan with a life insurance contract containing the waiver of premium benefit would relieve the employer of having to make premium payments in case of the employee's disability. Assuming a premium of $4,000, a corporation in a 34 percent tax bracket could pay $6,060 per year to the disabled employee, since the after-tax cost of these payments is equal to the nondeductible premiums being waived ($4,000 divided by one minus the employer's tax bracket, or $4,000 ÷ .66 = $6,060).

[5] Employer-owned life insurance must meet strict notice and consent requirements if the death benefits are to be received free of income taxes (see Company Owned Life Insurance (COLI), pages 357-359).

[6] During the first 20 years, it is assumed that $4,000 purchases either a universal life insurance contract providing for a death benefit equal to the face plus the cash values (Option 2), or a paid-up at age 65 participating contract (with dividends typically being used to purchase paid-up additions). Once the employee reaches age 65, the chart assumes that the corporation will make retirement payments from *current* cash flow, as opposed to utilizing the contract's cash values. By maintaining the contract, the corporation will eventually receive the death benefit, which may more than offset its cumulative outlay. Assuming a 34 percent tax bracket and no alternative minimum tax, the after-tax cost of making a $10,000 payment is $6,600 (for sample calculations see footnote 5, page 239). Use of computer-prepared illustrations can provide a variety of funding options and schedules.

[7] Because the corporation is both owner and beneficiary of the life insurance contract, the premium payments that it makes are *not* tax-deductible. In this sense, the contract is carried in the same manner as key person insurance, the difference being the *purpose* for which the death benefit will be used. To avoid any current tax liability to the employee, it is essential that the employee have no vested interest in a fund or any investments intended to secure the deferred compensation payments. The life insurance contract must remain the unrestricted asset of the employer, available to general creditors of the employer, and the employee can have no interest in the contract (see discussion on page 360). Despite this, it is generally recognized that the use of life insurance to back up a deferred compensation agreement provides some psychological security to the employee, in the sense that the employer is preparing to follow through on its commitment. Alternatives such as a Restrictive Bonus Plan, a Rabbi Trust or a Secular Trust might also be considered (see pages 220, 521, and 548).

[8] Under some circumstances, the cash values and death benefits could be subject to the corporate alternative minimum tax, as discussed on pages 363-365.

DISABILITY – THE LIVING DEATH

No estate or financial plan can be considered complete unless there has been an evaluation of the risks of disability. *Planning to live* is as important as *planning to die*, and the risk is greater. For example, for a male age 40, long-term disability is 2.9 times more likely than death.

Before disability, most people are able to acquire savings to the extent income exceeds expenses. However, **after disability** caused by a sickness or injury, income will *fall* and expenses will *rise*.[1]

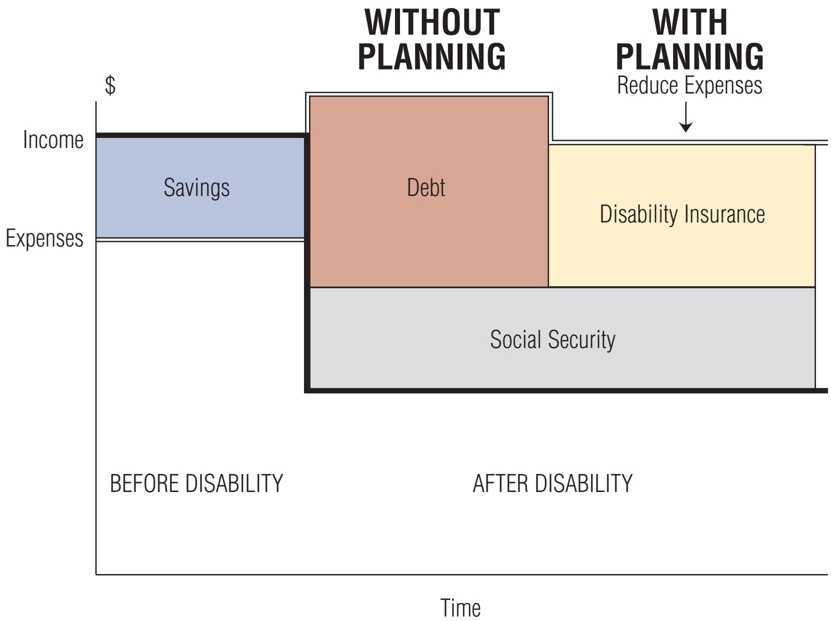
WITHOUT PLANNING, the expenses of a disability can quickly exhaust the family's savings and create substantial debt. This is true despite the availability of Social Security after six months of continuous and total disability. For most people these payments will rarely fill the gap created between falling income and increasing expenses. When available, Social Security disability payments to a disabled wage earner with children will be substantially more than those to a disabled wage earner without children. The fact that a disabled wage earner is married – and often responsible for the financial needs of a spouse – does not result in an increase in Social Security payments.

Attempting to reduce expenses by selling personal possessions, a car, or even the family home, is unlikely to eliminate the substantial debt which is created by a long-term disability, which is often referred to as "the living death."

WITH PLANNING, the cornerstone of any disability plan is **disability insurance**. Just as life insurance protects a family in case of the insured's death, disability income insurance protects *both* the insured and his family in case of the insured's disability. In addition, before disability strikes, the purchase of a comprehensive **major medical expense plan** offers one of the most effective ways of paying the major expenses of many disabilities. A **waiver of premium rider** on existing or new life insurance policies will provide for payment of premiums after a stated period of disability.[2]

Today, many life insurance contracts can be purchased with riders that also protect against disability or chronic illness. See pages 469-470.

Footnotes on page 247



RISK OF LONG-TERM DISABILITY - RISK OF DEATH

	Male	Female
Age 30 –	4.0 times more likely	7.6 times more likely
Age 40 –	2.9 times more likely	5.9 times more likely
Age 50 –	2.3 times more likely	3.8 times more likely

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Annual earned income.
6. Occupation.
7. Present disability coverage:
   a. Individual policies – benefits and duration.
   b. Group insurance – benefits and duration.
   c. Covered by Social Security?
   d. Covered by state worker's compensation?

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 313. Employer can deduct as a business expense amounts paid for disability income policy for employee.
Q 324. Disability income benefits received from personally paid policies are tax free.
Q 327. Taxation of benefits when provided for stockholder-employees only.
Q 646. Tax credit for the permanently and totally disabled.

Footnotes

[1] The expenses associated with a long-term disability can be devastating. With death, the funds required are those needed to support a surviving family. With disability, the living death, not only is there a need to provide for the family, but the living and medical expenses of the disabled person must also be provided. The advances of modern medicine and equipment, which have enabled many more people to survive crippling accidents and illnesses, have further added to the expenses of long-term care. See the chart on page 261 regarding the risk and costs of long-term care.

[2] In addition to disability income insurance, the owners of a business should consider funding their buy/sell agreements with disability buy-out insurance (see page 376). Also, business overhead expense insurance can provide for payment of specific business expenses during a period of disability (see discussion, page 338).

DISABILITY INCOME PLAN

When a disabled employee is faced with increasing expenses and decreasing income, many corporate employers will informally continue the disabled employee's salary for an extended period of time. Such an approach can be unwise when the disabled employee is a stockholder. To illustrate, assume that a corporation's income is $150,000 before paying a $50,000 salary to its employee-stockholder.[1]

NO PLAN. If this employee-stockholder becomes disabled without a pre-existing plan, continued salary payments of $50,000 could be treated by the IRS as *nondeductible dividends*, which must come from after-tax profits. Assuming the taxable income of the business does not suffer because of the key employee's disability, taxable income would then be $150,000, upon which $41,750 of taxes must be paid, with $58,250 remaining after-tax and after payment to the disabled stockholder-employee.

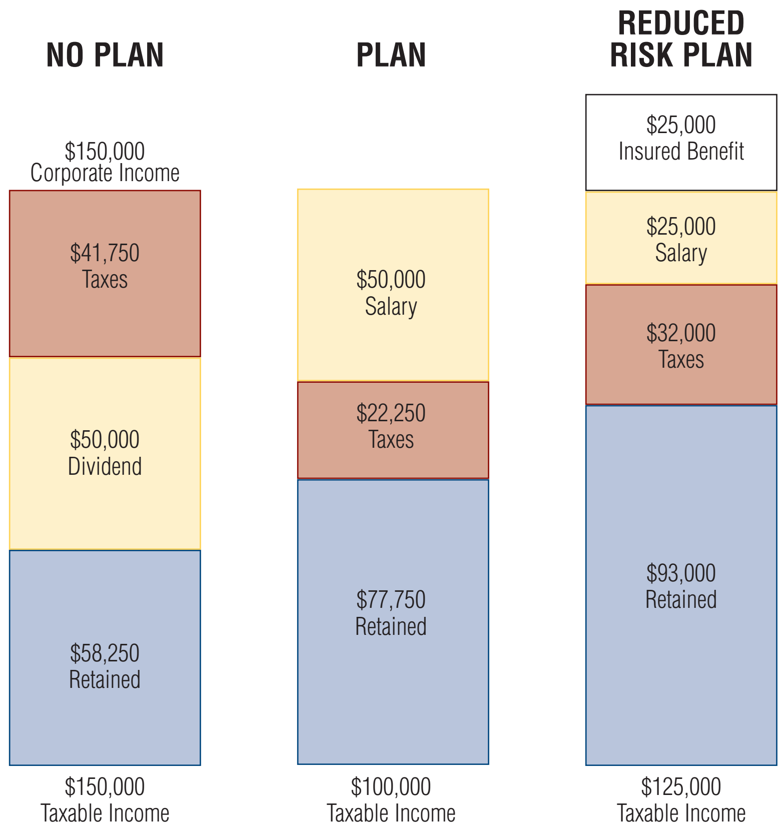
PLAN. A pre-existing disability income plan would enable the corporation to preserve the tax-deductibility of these continued salary payments to the disabled employee-stockholder. This would place the corporation in the same position as existed prior to the employee-stockholder's disability.

To establish a plan, three things are required: (1) a corporate resolution must be adopted; (2) a plan document must be prepared; and (3) notification of the plan's existence must be given to the covered employee.[2] By doing this, the corporation could deduct continued salary payments and retain $77,750 after paying taxes of $22,250. Compared to "no plan," this represents a saving of $19,500 per year. Such plans may be *highly selective*, and a class may consist of just one employee, provided it is a "reasonable" classification. If stockholders are covered, it must be in their capacity as employees.

REDUCED RISK PLAN. Under the reduced risk plan, the corporation shifts a part of its liability to an insurance company.[3] With an individual disability income contract, an insured benefit of $25,000 per year could be paid directly to the disabled employee-stockholder.[4] The corporation would deduct a continued salary payment of $25,000, with $125,000 of taxable income remaining with the corporation. After paying taxes of $32,000, the corporation then retains $93,000. When compared to "no plan," this represents a saving of $34,750 per year.

With a reduced risk plan the premium is deductible by the corporation, yet not taxable to the employee, who is *assured* of receiving disability payments if the corporation should fail.[5]

Footnotes on page 251



REQUIREMENTS FOR A "PLAN"

- Corporate Resolution
- Plan Document
- Notification to Employee

KEY FEATURES OF THE "REDUCED RISK PLAN"

- Premiums Deductible by Corporation
- Premiums Not Taxable to Employee
- Employee is Assured of Payments

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.

To Demonstrate Benefit of Insured Plan

5. Annual earned income of employee-stockholder.
6. Corporate income (to calculate taxes and retained earnings, as demonstrated in chart).

To Determine Amount of Coverage

7. Occupation.
8. Present disability coverage:
   a. Individual policies – benefits and duration.
   b. Group insurance – benefits and duration.
   c. Covered by social security?
   d. Covered by state worker's compensation?

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 313. Employer can deduct as a business expense amounts paid for disability income policy on employee.
Q 315. Premiums paid by employer are not taxable income to employee.
Q 317. Disability income payments are fully taxable to employee (except portion of income attributable to employee's contributions, if any).
Q 324. Disability income benefits received from personally paid policy are tax-free.
Q 327. Taxation of benefits when provided for employee-stockholders only.
Q 646. Tax credit for the permanently and totally disabled.

Footnotes

[1] Although a corporation has been selected to demonstrate the tax problems that can occur when an employee-stockholder becomes disabled, a disability income plan can be established for the *employees* of a partnership or a sole proprietorship. However, the partners and the sole proprietor are not "employees" and cannot exclude from their incomes premiums paid for disability income insurance. On the positive side, benefits received by a partner or sole proprietor are totally free of income taxes, because premiums are paid with after-tax dollars. For this purpose, the stockholder who owns more than two percent of an S corporation will be treated the same as a partner in a partnership (see pages 539-541).

[2] Notification given by himself as an officer, to himself as an employee, that the board of directors, on which he serves, has established a disability income plan for him, may appear unnecessary, but that is what is required. For appearance's sake, it would be preferable to have another officer sign the letter of authorization.

[3] Despite the tax advantages of having a pre-existing plan, it alone *will not guarantee* that salary continuation payments will be made to a disabled employee. This is particularly true if the corporation is liquidated because of the extended absence of the owner during a long-term disability.

[4] The maximum coverage that most insurers will issue for long-term disability is generally limited to 60 percent of pre-disability earned income, reduced to account for other disability insurance and anticipated Social Security or state lump-sum benefits. However, reliance upon Social Security to provide the needed disability benefits may be ill-advised in view of the strict qualification requirements (see Disability Under Social Security, page 379).

[5] Provided they are *reasonable*, corporate premium payments are deductible as a business expense. Although the *premium* is not taxable to the employee, if and when disability *payments* are received by the employee, they will be taxed as salary. In order for the employee to receive tax-free payments, he must have paid the premiums. By including the premiums paid by the employer in his taxable income, the employee will be considered as having paid the premiums with his own after-tax dollars. He can then receive the disability payments tax-free. This is a decision to be made by the employee, and it will not affect the deductibility of the amount equal to the premium paid by the employer. The concept is sometimes referred to as a "Section 162 Bonus Plan," and is similar to that described in the Executive Equity chart on page 217. To determine the various tax ramifications of premium and benefit payments under different arrangements, see the table on page 326.

The calculations of the figures used in this chart:

			No Plan	*Plan*	*Reduced Risk Plan*
Corporate Income			$150,000	$150,000	$150,000
Less Salary			0	(50,000)	(25,000)
Taxable Income			$150,000	$100,000	$125,000
Tax on:	first	$ 50,000 (15%)	$ 7,500	$ 7,500	$ 7,500
	next	25,000 (25%)	6,250	6,250	6,250
	next	25,000 (34%)	8,500	8,500	8,500
	amount over	100,000 (39%)	19,500	0	9,750
Total Tax			$41,750	$22,250	$32,000

The 5 percent surtax on income between $100,000 and $335,000 is reflected in the 39 percent rate used in this table (see income tax table on page 585). This calculation ignores possible state income tax which would only magnify the issues.

HEALTH REIMBURSEMENT ARRANGEMENTS

Under a health reimbursement arrangement, it is possible to pay for the medical expenses of an employee and the employee's dependents.[1]

MEDICAL EXPENSES include items such as doctor bills, dentist bills, hospital bills, transportation, prescription drugs, dentures, nursing services, eyeglasses, and hearing aids. The ideal plan has the cost of the benefit tax deductible to the employer and not includable in the employee's income.

SELF-INSURED ARRANGEMENTS will cause highly compensated individuals to be taxed on part or all of any reimbursements, unless the arrangement is nondiscriminatory as to benefits provided and meets one of three eligibility requirements:[2]

1. The IRS has found specific eligibility classifications within the arrangement to be nondiscriminatory;
2. 70 percent or more of employees benefit from the arrangement; or
3. 70 percent or more of all employees are eligible, and at least 80 percent of the 70 percent actually benefit from the arrangement.

If a self-insured arrangement does not meet one of these three requirements, then the highly compensated individuals who will be taxed include:

- Any stockholder who owns more than 10 percent of the stock.
- The 5 highest paid officers.
- Any employee who is among the 25 percent highest paid of all employees.

These arrangements must also comply with many of the requirements of the Patient Protection and Affordable Care Act (the Health Care Act). Some of the more significant include: (1) prohibition of preexisting condition exclusions; (2) prohibition on excessive waiting periods; (3) no lifetime or annual limits; (4) prohibition on rescissions; (5) coverage of preventive health services; and (6) extension of dependent coverage.

INSURED ARRANGEMENTS cannot be used to provide tax benefits to stockholder-employees or officers by segregating them from other employees.[3] Under the Health Care Act, policies purchased on or after September 23, 2010, will be subject to nondiscrimination requirements (i.e., these arrangements can no longer be used to benefit a select class of employees).

Footnotes on page 255

MEDICAL EXPENSES

Doctor Bills - Dentist Bills - Hospital Bills
Transportation - Prescription Drugs - Dentures
Nursing Services - Eyeglasses - Hearing Aids

SELF-INSURED ARRANGEMENTS

will cause highly compensated
individuals to be taxed, unless
plan is nondiscriminatory as to benefits
and

Classifications Found By IRS As Nondiscriminatory

OR

70% Of Employees Benefit

OR

70% Of Employees Eligible And 80% Of The 70% Actually Benefit

HIGHLY COMPENSATED INDIVIDUALS INCLUDE

Stockholder Who Owns More Than 10% Of Stock

5 Highest Paid Officers

25% Highest Paid Employees

INSURED ARRANGEMENTS

Cannot Benefit A Select Class of Employees

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of employee.
2. Date of birth.
3. Smoker/nonsmoker.
4. Salary.
5. Status of employee (full time or part time).
6. Employment date.
7. Employer's tax bracket.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 315. Value of health coverage not generally taxable to employee.
Q 317. Employee taxation of payments received under employer provided health insurance.
Q 318. Employee taxation of benefits provided under employer's noninsured plan.
Q 319. Nondiscrimination requirements that apply to employer provided health benefits.
Q 320. Nondiscrimination requirements that apply to self-insured health plans.
Q 322. Taxation of amounts paid to highly compensated employees under a discriminatory self-insured medical reimbursement plan.
Q 326. Taxation of "domestic partnership" benefits.
Q 327. Taxation of benefits when provided by C corporations for stockholder-employees only.
Q 328. Taxation of health insurance coverage for partners and sole proprietors.
Q 329. Taxation of health insurance coverage for S corporation stockholders.
Q 335. Coverage continuation requirements under "COBRA."
Q 398. New health insurance nondiscrimination rules affect on insured plans.
Q 399. How to determine if a health plan is discriminatory.
Q 400. The consequences of violating the nondiscrimination rules.
Q 402. Application of health reform to self-insured plans.

Footnotes

[1] A health reimbursement arrangement can be provided for the *employees* of a C corporation, a partnership, or a sole proprietorship. However, the partners of a partnership and the sole proprietor cannot be covered and receive the same tax benefits, as they are not considered "employees." Only the stockholders of a corporation who are also employees of the corporation can be covered and receive the tax benefits. For this purpose, the stockholder-employees of an S corporation who own more than 2 percent of the outstanding stock or voting power are treated the same as partners (see pages 539-541). Sole proprietors and partners can deduct 100 percent of amounts paid during the taxable year for medical insurance for themselves and their dependents. To take the deduction, the individual must not be eligible to participate in any subsidized health plan maintained by his employer or his spouse's employer. The deduction is allowable in determining adjusted gross income (but is limited to the amount of the individual's income from the business for which the plan was established).

[2] Routine physical examinations, blood tests, and X-rays (that are not for a known illness or symptom) are not subject to the nondiscrimination requirements (i.e., the "medical diagnostic procedures" exception). In addition, despite having to include in income reimbursements under a discriminatory self-insured plan, a "highly compensated individual" may be able to claim a portion of his reimbursements as an itemized deduction. Medical and dental expenses, prescription drugs, and medical insurance premiums, which in total exceed 10 percent of adjusted gross income, may be deducted if the taxpayer itemizes deductions. For example, assume we have two employees, each of whom had $4,000 of medical expenses, which were fully reimbursed under a *discriminatory* medical reimbursement plan:

	Employee A	*Employee B*
Adjusted Gross Income	$ 25,000	$ 40,000
	× 10%	× 10%
Amount That Cannot Be Deducted	$ 2,500	$ 4,000
Medical Expenses Reimbursed	$ 4,000	$ 4,000
Less: Amount That *Cannot Be Deducted*	(2,500)	(4,000)
Amount That *Can Be Deducted*	$ 1,500	$ 0

[3] The Patient Protection and Affordable Care Act generally extended the *nondiscrimination rules* applicable to non-insured plans to insured plans. However, employer-provided health insurance policies in existence on March 23, 2010, were grandfathered and may continue to discriminate in favor of highly compensated employees. Policies purchased after March 23, 2010, and before September 23, 2010, are subject to the nondiscrimination requirements beginning with the first plan year beginning after September 23, 2010. Failure to satisfy the nondiscrimination requirements will subject the employer to a $100 per day/per affected participant excise tax.

HEALTH SAVINGS ACCOUNTS

Offering an attractive means of funding future health care costs, a health savings account (HSA) can be established by eligible individuals covered by a high deductible health plan (HDHP), provided they are not claimed as a dependent on another person's income tax return and are not entitled to benefits under Medicare (i.e., have not reached age 65).[1] The required HDHP must provide for a *minimum* annual deductible of at least $1,300 for individual coverage and $2,600 for family coverage; and *maximum* annual out-of-pocket expenses must be limited to $6,450 for individual coverage and $12,900 for family coverage (as adjusted in 2015 for inflation). As an exception to these deductibles, preventive care services may be covered on a first-dollar basis.[2]

Annual contributions to the HSA are limited to a maximum of $3,350 for an individual, or $6,650 for a family (as adjusted in 2015 for inflation). Account holders and covered spouses, aged 55 and over, may each make additional contributions of $1,000 in 2015.[3] Both the account holders and their employers can make contributions, but total contributions cannot exceed these annual limits.[4] Employer contributions for all similarly situated employees must be "comparable" (i.e., the same dollar amount or percentage of the annual deductible limit). The account is entirely owned by the employee. Because unused funds may be carried over from year-to-year, for many individuals it may be possible to accumulate substantial amounts prior to retirement.[5]

HSAs offer substantial tax advantages.[6] **Contributions** made by an individual are fully deductible from income as an "above the line" deduction (i.e., without regard to whether deductions are itemized). Employer contributions are deductible by the employer, are not taxable to the employee, and are not subject to Social Security and federal unemployment taxes. **Earnings** within the account are tax-deferred. **Distributions** are tax-free, provided they are for "qualified medical expenses," a term that is broadly construed to include items such as braces and nursing home costs (but not over-the-counter medications or cosmetic surgery). Distributions other than for qualified medical expenses are taxable and subject to a 20-percent-penalty tax.[7]

Although payments of health insurance premiums are not considered qualified medical expenses, exceptions allow tax-free reimbursements for premiums paid for a qualified long-term care insurance contract, premiums for COBRA continuation coverage, and premiums for healthcare while receiving unemployment compensation. For those who are eligible for Medicare, tax-free distributions can be made for post-age 65 health insurance such as Medicare Parts A, B, C, and D, and employer-sponsored retiree health insurance (but not for a Medicare supplement policy).[8]

Footnotes on page 259

Individual

Covered By

HDHP
High Deductible Health Plan

Minimum Deductible
- Individual ~~$1,250~~
- Family ~~$2,500~~

Maximum Out-Of-Pocket
- Individual ~~$6,350~~
- Family ~~$12,700~~

May Establish

HSA
Health Savings Account

Contribute Maximum of
- Individual ~~$3,300~~
- Family ~~$6,550~~

Plus Catch-Up Contribution If Age 55+
- Individual $1,000
- Spouse $1,000

TAX ADVANTAGES OF HSA

CONTRIBUTIONS	EARNING	DISTRIBUTIONS
Tax-Deductible	Tax-Deferred	Tax-Free

TAX-FREE DISTRIBUTION MUST BE FOR "QUALIFIED MEDICAL EXPENSES"

- Medical Care For Individual, Spouse & Dependent
- Premiums For Qualified Long-Term Care Insurance
- Premiums For Health Insurance During Period:
  - Of COBRA Continuation Coverage
  - Receiving Unemployment Compensation
- Premiums For Post-Age 65 Health Insurance Such As:
  - Medicare Part A, Part B, Part C, or Part D Coverage
  - Employer-Sponsored Retiree Health Insurance

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual.
2. Date of birth.
3. Annual income.
4. Names and ages of dependents.
5. Details regarding current health insurance (to include coverage, deductibles, and maximum out-of-pocket expense).
6. Employment status (i.e., employee of another or self-employed).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 369. Description of a Health Savings Account (HSA) and how it can be established.
Q 370. Definition of an "eligible individual" for purposes of a HSA.
Q 371. Definition of a "high deductible health plan" for purposes of a HSA.
Q 372. Limits on contributions to a HSA.
Q 373. An employer offering a HSA to its employees must make "comparable" contributions for comparable employees.
Q 377. Penalty for making excess contributions to a HSA. Treatment of excess contributions.
Q 379. Taxation of funds accumulated in a HSA prior to distribution.
Q 380. Taxation of amounts distributed from a HSA.
Q 381. Transfer of funds into a HSA.
Q 382. Transfer of an individual's interest in a HSA as part of a divorce or separation.
Q 383. Disposition of a HSA upon the death of the account holder. Treatment of a surviving spouse as account owner.
Q 384. Amounts contributed to a HSA are not subject to social security taxes.
Q 385. Employer contributions to a HSA on behalf of an employee are not subject to withholding.
Q 386. Tax reporting requirements that apply to a HSA.
Q 410. Distributions from a HSA that do not qualify as medical expenses under the Patient Protection and Affordable Care Act (i.e., nonprescription drugs).

Footnotes

[1] HDHPs can also include self-insured medical reimbursement plans that are sponsored by an employer. See chart on page 253.

[2] The "preventive care" safe harbor allows HDHP coverage for items such as periodic physical exams, routine prenatal and well-child care, immunizations, tobacco cessation programs, obesity weight-loss programs, and a long list of health screening services that includes, among others, mammograms and PSA tests (i.e., these services can be provided without regard to the $1,300 and $3,000 deductibles). If prescription drug coverage provides a benefit before satisfying the required deductible it would prevent tax-deductible contributions to a HSA. Permitted is insurance for a specific disease or illness, accident and disability insurance, and coverage for dental care and vision care. In sum, only preventive care services, permitted insurance, and permitted coverages are allowed in conjunction with a HDHP.

[3] Calendar year taxpayers have until April 15 of the following year to make contributions for the previous year (filing extensions do not extend the time). No contributions are allowed once an individual has reached age 65.

[4] A participant in a health reimbursement arrangement (HRA), or a health flexible spending account (FSA), may, one time per arrangement, make an employer-to-trustee transfer to a HSA (see overview of Medical Expense Programs, on page 324). This transfer will be treated as a rollover contribution to the HSA (i.e., it will not count toward the annual HSA contribution limit). In addition, individuals who own either a traditional or a Roth IRA may make a one-time trustee-to-trustee transfer from their IRA to a HSA (referred to as an "IRA-HSA rollover"). This transfer will not be included in the individual's income, nor will it be subject to the 10-percent penalty tax for premature withdrawals. However, the amount cannot exceed the individual's maximum HSA contribution limit for the year (in 2015, $3,350 for individuals and $6,650 for families).

[5] Tax-deferred accumulation of earnings and no requirement to withdraw funds at any particular time makes the HSA particularly advantageous as a savings vehicle for future health care expenses (e.g., expenses incurred after age 65). For example, assume a family is covered by a HDHP. In 2015 this allows a maximum annual deposit into the HSA of $6,650. Contributions to a HSA may be invested in the same manner as contributions to an IRA (e.g., in stocks and bonds). Of course, the HSA is also available for spending on current medical costs or to reimburse the account holder for incurred health care costs.

[6] Lower-paid employees in the lowest tax brackets are less likely to benefit from these tax-deductions. Critics of HSAs maintain that for lower-paid employees with substantial health care costs these tax benefits may prove largely illusory. The perceived cost-shifting of the cost of health care to workers is also of concern when an employer switches from a comprehensive coverage program to a high-deductible health plan in order to reduce premium costs. In response, proponents of HSAs maintain that increases in health care costs have excluded many people (particularly the self-employed) from having any health care insurance; and HSAs, together with HDHPs, will make insurance more affordable. It is also argued that savings will come from engaging the health care consumer in health care choices.

[7] Under the Patient Protection and Affordable Care Act of 2010 the penalty-tax was increased from 10 percent to 20 percent for distributions made on and after January 1, 2011. The penalty tax does not apply if the distribution is on account of the beneficiary's death, disability, or after reaching age 65 (i.e., has become eligible for Medicare).

[8] Prior to age 65, HSAs cannot be used to make tax-free reimbursements of an employee's share of health insurance premiums.

LONG-TERM CARE

Planning for long-term care is an integral part of retirement and financial planning. Long-term care consists of a continuum of services including nursing home care, assisted living, and home health and adult day care. The need can arise from an accident, illness, or advanced age.

THE RISK. Statistics make a very good case for long-term care planning. For example, a 65-year-old woman can expect to live another 20.1 years, and a 65-year-old man can expect to live another 16.8 years.[1] According to the U.S. Administration on Aging, 70 percent of people attaining age 65 will need some form of long term care during their lifetimes. During these years it is estimated that the risk of entering a nursing home is approximately 50 percent. .

THE COST. Nursing care is expensive. Although there is a large variation from one region to another, the average nursing home cost was $77,380 per year in 2014.[2]

MANAGING THE RISK. For an individual with substantial retirement income and assets self-insurance may be a realistic option. However, for those who cannot self-insure reliance upon government programs may be ill advised. For example, after a minimum three-day hospital stay Medicare will only pay for the first 20 days of *skilled nursing* care. From days 21 through 100 the patient must pay in 2015 the first $157.50 per day, and all costs after 100 days. Medicare does not pay for *custodial* care.[4] Although Medicaid will pay for custodial care, the patient must first "spend down" assets in order to qualify.[5] Private insurance is often considered by those desiring independence and choice of care and benefits.[6] It also provides asset protection from the Medicaid spend down requirements.

PRIVATE INSURANCE provides flexibility by allowing individuals to obtain care in various settings and at different levels (skilled nursing, intermediate and custodial care). Contracts do not require prior hospitalization, are guaranteed renewable and offer level premiums.[7] Daily benefits run from $50 to $300 or more. The benefit periods are typically 2, 3, 4, or 5 years, or lifetime. Benefits are paid when the insured has a cognitive impairment or is unable to perform certain activities called "benefit triggers."[8] A deductible, in the form of an elimination period, will generally last from 0 to 180 days. Provisions for home health care and adult day care will allow the beneficiary to remain in the community. Of particular importance is waiver of premiums to limit premium costs and inflation protection to ensure an adequate daily benefit in the future.[9]

In addition to these basic components, other benefits are often available. These features include spousal discounts, respite care, hospice care, caregiver training, bed reservation, medical equipment, cognitive reinstatement, non-forfeiture benefits, case management and referral services.[10] Choosing from such a range of contract options requires a balancing of benefits and flexibility against premium costs.

Footnotes on page 263

THE RISK

The estimated risk of a 65-year-old person entering a nursing home is 70% according to the U.S. Administration on Aging (see www.longtermcare.gov).

THE COST

The average cost of nursing home care in the United States is ~~nearly~~ $77,380 per year for a semi-private room. There is, however, a large variation from one region to another around this national average. In many states the average cost exceeds $100,000 per year with the highest average state at over $200,000 per year.

MANAGING THE RISK

Government Programs
- Medicare
- Medicaid

Self-Insurance
- Income
- Assets

Private Insurance
- Independence & Choice
- Protection of Assets

PRIVATE INSURANCE

- Daily Benefit Amount
- Benefit Period
- When Benefits Paid
- Elimination Period
- Home Health Care
- Adult Day Care
- Waiver of Premium
- Inflation Protection

- Spousal Discounts
- Respite Care
- Hospice Care
- Caregiver Training
- Bed Reservation

- Medical Equipment
- Cognitive Reinstatement
- Non-Forfeiture Benefits
- Case Management
- Referral Services

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual to be insured.
2. Sex.
3. Date of birth (and spouse's date of birth).
4. Has individual or spouse been hospitalized in the last 5 years?
5. Has individual or spouse had any health problems?
6. What medications is the individual or spouse currently taking (include both dosage and frequency)?
7. What is the current monthly income and what monthly income is anticipated in retirement?
8. What is the net worth of the individual and spouse? (see page 12).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 424. Description of a "qualified" long-term care insurance contract.
Q 428. Description of "qualified" long-term care services.
Q 429. Grandfathering of long-term care contracts issued prior to 1997.
Q 430. Within limitation premiums for a qualified long-term care insurance contract are deductible as medical expenses.
Q 431. Subject to a dollar limitation the self-employed may deduct premiums for a qualified long-term care insurance contract.
Q 432. Premiums paid by an employer for a qualified long-term care insurance contract should be excludable from the employee's gross income.
Q 433. Premiums paid by an employer for a qualified long-term care insurance contract for employees should be deductible by the employer.
Q 434. Description of limitations on the amount of benefits received under a qualified long-term care insurance contract that may be excluded from income.
Q 435. Taxation of a "nonqualified" long-term care insurance contract.
Q 436. Reporting requirements applicable to long-term care benefits.

Footnotes

[1] See Commissioners 2001 Standard Ordinary Mortality Table on pages 591-592.

[2] Source of 2014 nursing home costs for a private room with skilled nursing care 24 hours a day: Genworth Financial 2014 Cost of Care Survey (www.genworth.com/costofcare). Because of the wide range of charges a local cost survey of various levels of care is strongly recommended. The "cost of waiting" to buy long-term care insurance can be considerable. Not only are premiums substantially more at older ages but additional coverage must be purchased to cover inflation (see footnote 9, below).

[3] Medicare will pay for medically necessary home health visits that are restorative in nature (i.e., the patient must be improving). However, Medicare will not pay for intermediate care or custodial care (see page 477). It should also be noted that Medigap coverage only pays Medicare deductibles or coinsurance, it does not extend the basic coverage.

[4] Simply put, "spend down" means liquidating assets to pay for long-term care until a level of financial indigence is reached and it is possible to qualify for Medicaid. When does such a "financial meltdown" become significant? The answer depends upon marital status. In most states a single individual cannot have more than $2,000 in countable assets. But the "indigent spouse rules" provide better treatment to a married couple with an at-home spouse. In 2015, many states allowed them to retain up to ~~$115,920~~ plus the home, automobile, household goods and personal belongings (and a minimum monthly income of $~~1,891.25~~ for the at-home spouse, as changed annually in July of each year). Amounts over these allowances are referred to as the "Medicaid deductibles."

[5] If an individual needs 24-hour-a-day custodial care, under Medicaid there is little or no provision for "community based care" (i.e., home care, assisted living or adult day care). It is understood that, on average, Medicaid pays about two-thirds as much as the private pay patient. Although a nursing home cannot, by law, treat patients differently depending on who is paying the bills, quality of care remains an issue. The Medicaid patients do not get private rooms. If the quality of care deteriorates, the family of a private pay patient can move him to a different facility.

[6] Premiums can be raised on a class basis. These features are offered either within the base contract or by contract rider. Long-term care insurance is also available on a group basis or as permanent life insurance that advances the death benefit.

[7] Typically, benefit payments are triggered by the loss of two or more activities of daily living (ADLs). These activities include eating, toileting, transferring, bathing, dressing and continence. There has been considerable debate over the quality of benefits under tax qualified versus nontax qualified products (e.g., the nontax qualified products will pay a benefit using the more liberal "medical necessity" standard). See the discussion of Qualified Long-Term Care Insurance on page 517.

[8] For younger insureds inflation protection is particularly important (e.g., a 50-year-old will not likely need coverage as soon as a 70-year-old, thus with inflation his care will cost more). Assuming 5 percent inflation per year, care that costs $3,750 a month today will cost $6,108 in 10 years and $9,948 in 20 years (see Future Value Table on page 598).

[9] It has been observed that eldercare may soon replace childcare as the number one dependent care issue. Good prospects for long-term care insurance are individuals in the so called "sandwich generation" (i.e., persons in their forties and fifties who still have children living at home, *and* are also providing for their own parents). In taking care of their parents these individuals have come to fully appreciate the problems of long-term care and generally do not want to be a burden on their own children.

TAX-FAVORED RETIREMENT PLANS

Tax-favored retirement plans can be established in a variety of ways.

- Qualified retirement plans such as defined benefit pension plans, money-purchase pension plans, and 401(k) plans, can be installed in a corporation, a partnership, or a sole proprietorship.[1]
- Individual retirement arrangements (IRAs), including both individual retirement accounts and individual retirement annuities, can be established by many taxpayers. With a simplified employee pension plan (SEP) or a SIMPLE IRA, employer contributions can also be made to individual retirement accounts.
- Section 403(b) plans are available to employees of public schools and colleges, and certain non-profit hospitals, and charitable, religious, scientific, and educational organizations.
- Section 457 plans are available to employees of state and local governments and tax-exempt organizations.

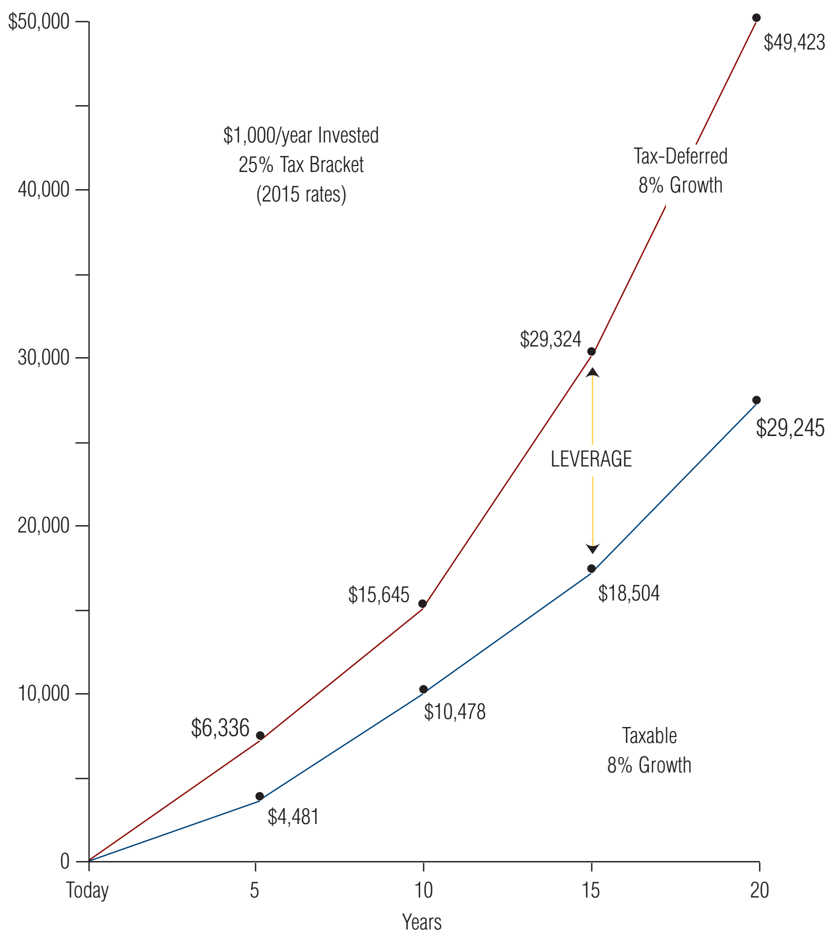
To better appreciate the advantages of tax-favored retirement plans, we can compare the growth of a tax-favored account to the results obtained when after-tax funds are invested outside a tax-favored plan … for example, in certificates of deposit, savings accounts, or treasury bills. Assume that there are $1,000 of before-tax funds available for investment per year over the next 20 years.[2]

Taxable Growth. If after-tax dollars were invested outside of a tax-favored plan, assuming a 25 percent tax bracket, of the original $1,000 only $750 per year would remain after-taxes for investment.[3] The earnings will also be taxed, which means that although the investment might pay 8 percent interest, it would yield only 6 percent after-taxes. The reduced after-tax funds available for investment, combined with the reduced after-tax yield, means that in 10 years $10,478 will have accumulated, and in 20 years $29,245.

Tax-Deferred Growth. The tax leverage provided by a tax-favored plan offers the opportunity for substantially increased accumulations, because there are no current taxes on contributions, and no current taxes on investment earnings. This means that each year $1,000 will actually be invested, and a full 8 percent rate of return will actually be credited, neither being subject to current income taxation. A tax-deferred growth of 8 percent will accumulate $15,645 in 10 years, and $49,423 in 20 years. Although payments received during retirement will be taxable, after-tax income will usually far exceed that available with investments that are not tax-favored.

Footnotes on page 267

TAX LEVERAGE



NO CURRENT TAXATION ON CONTRIBUTIONS & INVESTMENT EARNINGS

- Money Purchase Pension Plans
- Target Benefit Plans
- Profit Sharing Plans
- 401(k) Plans
- ESOPs
- Stock Bonus Plans
- Age-Weighted Profit Sharing Plans
- Thrift Plans
- Defined Benefit Plans
- Cash Balance Plans
- Keogh Plans For Self Employed (HR-10)
- Individual Retirement Arrangements (IRAs)
- SIMPLE IRAs
- Simplified Employee Pension Plans (SEPs)
- 403(b) Plans
- 412(i) Plans
- 457 Plans

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Names of employees.
2. Dates of birth.
3. Smoker/nonsmoker – when life insurance is to be used.
4. Salary schedule.
5. Status of employees – full time *or* part time.
6. Employment dates.
7. Retirement benefit – if defined benefit; *or*
   Dollar or percent contribution – if defined contribution.
8. Employer's tax bracket.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3567. Nonqualified deferred compensation tax benefits that are available to employees of state or local governments and other tax-exempt employers.
Q 3568. Requirements that a Section 457 plan must satisfy.
Q 3602. Description of individual retirement plan (IRA).
Q 3605. Description of a "deemed IRA."
Q 3615. Description of Roth IRA.
Q 3617. Rollover or conversion from traditional IRA to Roth IRA.
Q 3650. Description of simplified employee pension plan (SEP).
Q 3654. Description of SIMPLE IRA plan.
Q 3666. Description of defined benefit plan.
Q 3674. Description of defined contribution plan.
Q 3681. Description of pension plan.
Q 3682. Description of profit sharing plan.
Q 3697. Description of 401(k) plan.
Q 3707. Description of solo 401(k) plan.
Q 3715. Description of SIMPLE 401(k) plan.
Q 3734. Description of a 412(i) plan.
Q 3749. Description of Keogh (HR-10) plan.
Q 3757. Tax advantages of qualified pension and profit sharing plans.
Q 3758. Requirements for a plan to be "qualified."
Q 3903. Tax benefits of 403(b) tax sheltered annuities.
Q 3904. Organizations that can make 403(b) tax sheltered annuities available to their employees.
Q 3906. Requirements that must be met by 403(b) tax sheltered annuities.

Footnotes

1 The Qualified Plans Checklist on pages 306-307 provides a brief overview of some of the characteristics of qualified plans. Although some plans allow contributions of after-tax dollars, the chart on page 265 assumes all contributions are made from pre-tax dollars.

2 To estimate the total before-tax dollars that a wage earner can expect to receive assuming annual increases in earnings of either 5 percent or 8 percent, refer to the tables of Projected Earnings on page 318. To demonstrate the importance of starting early to save for retirement, refer to the Penalty Of Waiting table on page 319. The table entitled Early Saver vs. Late Saver on page 320 also illustrates the advantage of saving early for retirement. The table entitled How Money Grows on page 322 provides the accumulations for given amounts of monthly savings. How long these savings will last during retirement can be demonstrated using the table How Money Goes on page 323.

3 In return for *nondeductible contributions*, the Roth 401(k) feature permits *tax-free distributions* (see discussion on page 534). In contrast to the traditional IRA, the Roth IRA also permits tax-free distributions in return for nondeductible contributions (see discussions and analysis on pages 310-312, 424, 430, and 535).

401(k) PLAN

These plans allow eligible employees to defer compensation or bonuses and contribute the funds to an employer-sponsored profit sharing plan.[1] Known as cash or deferred arrangements (CODAs), they are funded entirely or in part through salary reductions elected by the employees.[2] Because employee participation in 401(k) plans is entirely voluntary, employers will often encourage participation by matching employee contributions. These matching contributions are typically limited to a maximum percentage and/or maximum dollar amount.[3]

One of the better ways of explaining the advantages of participating in a 401(k) plan is to contrast current nonparticipation with the benefits of participation (i.e., a "before and after" presentation).

WITHOUT PARTICIPATION. Assume that in 2015 a 35-year-old married employee with an annual salary of $52,000 currently pays $2,588 in federal income taxes, $1,560 in state income taxes and $3,978 in Social Security taxes. This leaves $43,875 of "take-home pay," with nothing set aside for retirement. (Calculation assumes: joint filing, four personal exemptions, standard deduction, and 3% of federal AGI state income tax.)

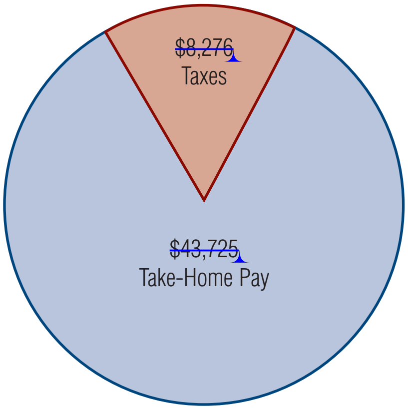
WITH PARTICIPATION. Now assume that this same employee has the opportunity to participate in a plan with a 50 percent employer match, (i.e., the employer will contribute one dollar for every two dollars of employee elective deferral).[4] If the employee elects to defer 6 percent of salary ($3,120 per year), the employer would then make a matching contribution of $1,560.[5] The total annual deposits to the employee's account are $4,680, consisting of the employee's elective deferral of $3,120 and his employer's matching contribution of $1,560. Because his contributions are before tax, the employee's federal income taxes are reduced to $2,120 and his state income taxes are reduced to $1,466. Social Security taxes are not affected by employee elective deferrals.[6]

Note that a reduction in take-home pay of only $2,558 has produced a deposit of $4,680 into the employee's retirement account. Because he pays $562 less in federal and state income taxes, take-home pay has been reduced by only $2,558, despite having contributed $3,120 to the plan (43,875 – 41,316 = 2,558).

A 35-year-old employee can accumulate $393,720 by age 65; assuming level plan contributions of $390 at the beginning of each month and 6 percent interest on plan assets. Over the same 30-year period, total employee contributions amount to only $93,600. Waiting just 5 years to begin participation would reduce age 65 projected accumulations to $271,619, which is $122,101 less than would accumulate assuming immediate participation (393,720 – 271,619 = 122,101).[7]

Footnotes on page 271

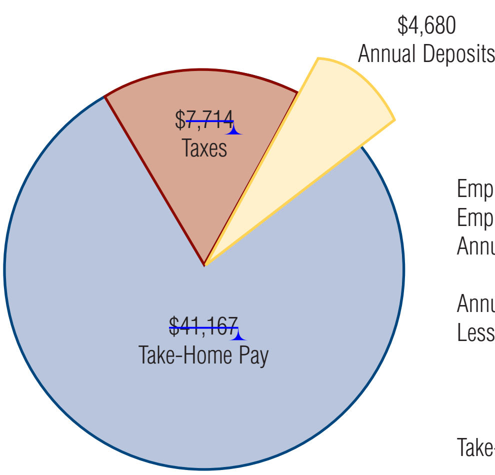
WITHOUT PARTICIPATION



Annual Salary	$52,000
Less: Federal Income Tax	~~2,738~~
State Income Tax	1,560
Social Security	3,978
Take-Home Pay	$~~43,725~~

WITH PARTICIPATION

Assuming 6% Deferral and 50% Employer Match



Employee Deferral	$3,120
Employer Match	1,560
Annual Deposits	$4,680

Annual Salary	$52,000
Less: Employee Deferral	3,120
Federal Income Tax	~~2,270~~
State Income Tax	1,466
Social Security	3,978
Take-Home Pay	~~$41,167~~

An annual reduction in Take-Home Pay of
$2,558 produces Annual Deposits of $4,680.

Assuming 6.00% interest and level contribution levels,
an employee age 35 would accumulate $393,720 by age 65.
Total employee contributions would be $93,600.

Waiting 5 years to begin participation would
reduce age 65 projected accumulations to $271,619.

401(k) Plan

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Names of employees.
2. Dates of birth.
3. Smoker/nonsmoker – when life insurance is to be used.
4. Salary schedule.
5. Status of employees – full time or part time.
6. Employment dates.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3697. General description of 401(k) plan.
Q 3698. Special qualification requirements for 401(k) plans.
Q 3705. Limits on elective deferrals.
Q 3706. Description of catch-up contributions.
Q 3707. Description of a solo 401(k) plan.
Q 3708. Description of an automatic enrollment safe harbor 401(k) plan.
Q 3710. Requirements for a 401(k) safe harbor plan.
Q 3715. Requirements for a SIMPLE 401(k) plan.
Q 3716. Requirements for Roth 401(k) feature.
Q 3729. Restrictions that apply to distributions from a 401(k) plan.
Q 3730. When hardship withdrawals may be made from a 401(k) plan.
Q 3731-Q 3732. The ADP and ACP tests.
Q 3733. Distributions of excess contributions and excess aggregate contributions.
Q 3751. Extent to which a qualified plan can provide life insurance benefits.
Q 3827. Definition of "highly compensated" employees.
Q 3843. Method used to determine cost of life insurance protection to employee participant.
Q 3865-Q 3866. Taxation of death benefit when employee dies prior to retirement.
Q 3867. Taxation of death benefit when employee dies after retirement.

Footnotes

[1] In addition to meeting the requirements necessary to qualify as a profit sharing or stock bonus plan, traditional 401(k) plans must: (1) limit the forfeitability and distribution of employee elective deferrals; (2) permit participation by the later of age 21 or one year of service; (3) limit elective deferrals to $18,000 in 2015 ($17,500 in 2013 and 2014); and (4) meet an annual nondiscrimination requirement (the ADP test), by comparing ratios of elective deferrals for highly compensated and nonhighly compensated employees. In contrast, employers can avoid the nondiscrimination testing required of traditional 401(k) plans if they are willing to make required contributions and meet other design requirements. See 401(k) Plan Designs, page 308.

[2] These amounts are referred to as "elective deferrals." It is helpful to remember that 401(k) plans can contain the following:

a. **Employee elective deferrals** – amounts the employee elects to have the employer contribute instead of receiving cash (the source might be existing salary, salary increases, or bonuses).

b. **Employer matching contributions** – made by the employer in some ratio to employee elective deferrals (if immediately 100 percent vested and subject to certain withdrawal restrictions, they are known as "qualified matching contributions").

c. **Employer nonelective contributions** – made by the employer on behalf of employees and not conditioned upon employee elective deferrals (if immediately 100 percent vested and subject to certain withdrawal restrictions, they are known as "qualified nonelective contributions").

d. **Catch-up contributions** – made by employees age 50 or over (see page 309).

[3] In 2015 the employer's tax deduction is 25 percent of total compensation. The typical plan design provides for the employer to match from 25 to 100 percent of employee *contributions* to a maximum of 5 to 10 percent of employee compensation.

[4] The employee elective deferral is limited to $18,000 in 2015 and $17,500 in 2013 and 2014 for traditional and safe harbor plans. Amounts deferred in excess of this limit (other than catch-up contributions) are not excludable from income, and, if not timely corrected by distribution, will be taxed a second time when distributed from the plan.

[5] Unless the plan is a safe harbor design (see page 308), the amount of elective deferrals must satisfy the ADP test. Matching contributions are often used to improve ADP results. The Actual Deferral Percentage (ADP) test is applied by dividing employees into two groups … the *highly* compensated, and the *nonhighly* compensated. The ADP test is met if either: (1) the deferral percentage for eligible highly compensated employees during the year does not exceed the deferral percentage of all other eligible employees in the *preceding* year multiplied by 1.25; *or* (2) the deferral percentage for eligible highly compensated employees during the year is not more than 2 percent higher than, nor more than 2 times, the deferral percentage for all other eligible employees in the *preceding* year (in either case, an election is available to compare current instead of preceding year results). An employee is potentially within the group of "highly compensated employees" if he:

a. Was a 5 percent owner at any time during the current or preceding year, or

b. Earned from his employer more than $120,000 for the preceding year (in 2015, as indexed for inflation) and, if the employer elects to apply this clause, was in the top 20 percent in relation to compensation for that year.

[6] Although most states allow an employee to exclude 401(k) contributions from taxable income, it would be advisable to check with individual state authorities.

[7] Provided it is an "incidental benefit," life insurance can be purchased within a 401(k) plan. Up to 49.9 percent of annual contributions can be used to purchase whole life insurance (24.9 percent if used to purchase universal life). The participant must include in gross income the "cost" of the insurance coverage (measured by multiplying the difference between the face amount and the cash surrender value by either the Table 2001 rates or the insurance companies' rates for individual 1-year term life insurance). If the employee dies prior to retirement, death proceeds in excess of cash surrender values are received free of income taxes.

403(b) PLANS

403(b) plans are available to employees of public schools and colleges, and certain non-profit hospitals, charitable, religious, scientific, and educational organizations.[1] The employee may supply the funds by agreeing to a salary reduction, or by foregoing a salary increase, or the employer may make contributions as additional compensation to the employee.[2] Contributions are *before taxes*, meaning that a participant is able to exclude the contributions from his current taxable income.[3]

Generally, with a salary reduction plan the lowest of these two limits may be excluded from income each year:

- A limit of $18,000 in 2015, which also includes total salary reduction contributions to Section 401(k) Plans, Simplified Employee Pension Plans and SIMPLE IRAs. "Catch up" provisions allow: (1) certain employees with 15 years of service to increase this amount by an additional $3,000; and (2) employees who have attained age 50 to increase this amount by an additional $6,000 in 2015.
- The lesser of $53,000 in 2015, or 100 percent of compensation, made to all 403(b) plans and, under some circumstances, retirement plans.

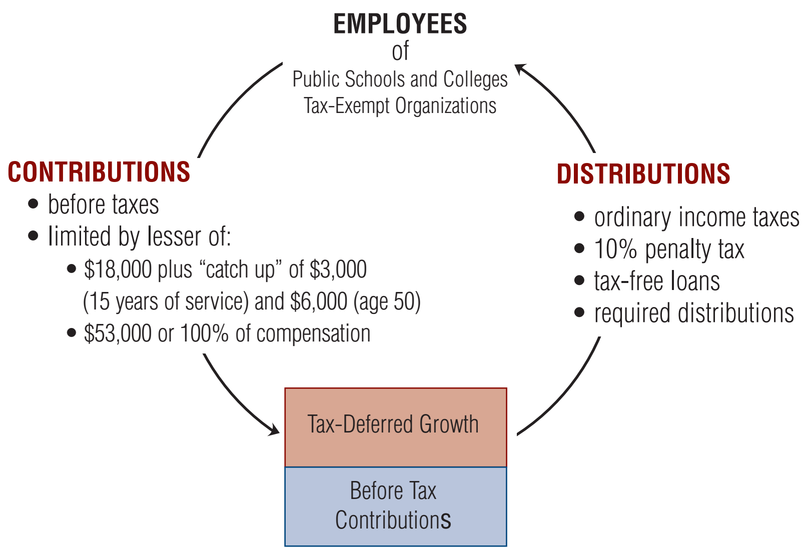
The compounding effect of before tax contributions and tax-deferred growth may result in substantially increased accumulations.[4] Because the annuity is generally portable to another qualified employer, contributions may be continued when changing employment.

Distributions from tax deferred annuities are subject to ordinary income taxes, unless rolled over into a traditional Individual Retirement Arrangement (IRA), another 403(b) plan, a 401(k) plan, a 457 government plan, or a 401(a) qualified retirement plan.[5] In addition, withdrawals may be subject to a 10-percent penalty tax. However, penalty-free withdrawals are allowed once the participant has attained age 59½, separated from service after attaining age 55, or under other specific circumstances.[6] With some restrictions, tax-free loans are also available.[7]

Required distributions of amounts accruing after 1986 generally must begin by April 1st of the year following the year in which the employee retires or attains age 70½, whichever is later.[8] Payments made under an annuity contract may be for the life of the employee (or lives of the employee and his beneficiary), or a period certain not longer than the life expectancy of the employee (or joint and last survivor life expectancy of the employee and his beneficiary).

Footnotes on page 275

SALARY REDUCTION PLAN



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of employee.
2. Date of birth.
3. Marital status.
4. Salary (annual, monthly, weekly).
5. Assumed current tax bracket.
6. Employment date.
7. Projected retirement age.
8. Prior participation in tax deferred annuity plan.
9. Current participation in any qualified plan.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3890. Rollovers from 403(b) tax sheltered annuities.
Q 3907. Tax benefits of 403(b) tax sheltered annuities.
Q 3908. Organizations that can make 403(b) tax sheltered annuities available to their employees.
Q 3909. Methods of funding 403(b) tax sheltered annuities.
Q 3910. Requirements that must be met.
Q 3911. Nine requirements of a tax sheltered annuity contract.
Q 3913. Minimum nondiscrimination requirements.
Q 3917. Limits on excludable contributions.
Q 3918. Section 415 overall limits.
Q 3921. Salary reduction limits.
Q 3935. Taxation of incidental life insurance protection.
Q 3937. Loans under a 403(b) tax sheltered annuity.
Q 3948. Distributions subject to penalties.
Q 3949-Q 3957. Required distributions.
Q 3958. Taxation of payments received by employee.
Q 3959. Taxation of death benefits received by employee's beneficiary.
Q 3960. Effect of salary reduction on social security tax and income tax withholding.

Footnotes

[1] A 403(b) plan is also referred to as a "tax sheltered annuity," or "TSA." Rather than "tax *sheltered* annuity," the Securities and Exchange Commission prefers the term "tax *deferred* annuity." Many companies now use the terms "tax deferred annuity" and "TDA," particularly when marketing variable annuities (see footnote 3, page 291, regarding licensing and prospectus requirements). 403(b) plans are also referred to as: (1) "qualified" annuity plans; and (2) "501(c)(3) plans" or "501(c)(3) pensions" (Section 501(c)(3) describes certain tax-exempt organizations).

[2] Nondiscrimination rules may apply to both salary reduction and employer contributions.

[3] Where a reduction in salary is taken to provide the premium payments for a 403(b) plan, Social Security taxes and benefits are based upon the *unreduced* salary (i.e., although income taxes are reduced, there is no reduction in Social Security taxes).

[4] The chart on page 265 demonstrates the leverage afforded by the typical tax-favored retirement plan. Investing in a *variable* 403(b) plan provides a particularly attractive opportunity for dollar cost averaging (see graph, page 321).

[5] However, if the employee has an investment in the contract, he is allowed a tax-free recovery of his investment. Examples of an employee's *investment in the contract* include: (1) any premiums that he has paid with nondeductible dollars; (2) any employer contributions that were taxable to him by virtue of having exceeded his exclusion allowance in years before 2002 or the overall limit; (3) the sum of the annual one-year term costs that were taxable to him (where the contract provided life insurance protection); and (4) the amount of any loans included in income as a taxable distribution. When benefits are received in installments, or as a life income, the employee's investment in the contract requires the calculation of an exclusion ratio. The method used to determine the exclusion ratio depends upon the annuity starting date. Distributions are generally subject to mandatory withholding of 20 percent unless the employee elects a direct rollover.

[6] These additional specific circumstances include: (1) death; (2) disability; (3) as a part of substantially equal periodic payments beginning after separation from service; (4) when used for medical expenses exceeding 7.5 percent of adjusted gross income; (5) distribution of excess contributions within the same calendar year; (6) payments to an alternate payee under a qualified domestic relations order; and (7) penalty-free withdrawals for military reservists.

[7] The maximum tax-free loan is generally one-half the contract value, or $50,000, whichever is less. However, an exception is available for the first $10,000 of cash value, all of which may be borrowed. Loan repayments must be made at least quarterly and in amounts that allow for amortization over five years, except for loans to purchase a primary residence, which may be repaid over a longer "reasonable" period.

[8] These rules apply whether the distribution is calculated under the 1987, 2001, or 2002 regulations. However, different rules apply when distributions are not made as an annuity. See pages 430-431.

412(i) PLANS

A 412(i) plan is a defined benefit plan that is funded by life insurance and annuities.[1] Since the Pension Protection Act of 2006, these plans are now governed by IRC Section 412(e)(3) and are, therefore, sometimes promoted as 412(e) plans. These plans provide high-earning business owners who have stable cash flow an opportunity to make maximum deductible retirement contributions while offering a high degree of security to plan participants.

PLAN REQUIREMENTS. 412(i) plans are subject to all the requirements that apply to other defined benefit plans, including nondiscrimination, vesting and benefit limitations.[2] In addition, they must generally meet the following six additional requirements: (1) the plan must be funded exclusively by life insurance policies and/or annuities guaranteed by a state licensed insurance company; (2) contracts must have level premiums; (3) benefits must be provided entirely by these contracts; (4) premiums must be paid without lapse; (5) contract rights cannot be subject to a security interest; and (6) no policy loans are allowed.[3]

FUNDING. Known as "fully insured" plans, 412(i) plans are typically funded with a combination of life insurance and annuities.[4] The primary purpose of the plan must be to provide retirement income. Therefore, when life insurance is used it must provide participants with no more than an "incidental" death benefit. To satisfy this requirement defined benefit plans often limit the insured death benefit to not more than 100 times the expected monthly benefit.[5] Excessive funding may result in nondeductible contributions and "listed transaction" status. Each plan participant has the right to name the beneficiary of this death benefit and must include in income an amount equal to the "economic benefit" of the life insurance benefit.[6]

THE TRADEOFFS. Because **412(i) plans** are exempt from the full funding limit that otherwise applies to defined benefit plans, they offer (within limits) the opportunity to make accelerated contributions resulting in large upfront tax deductions. Simplicity is achieved with conservative low-risk life insurance and annuity contracts that shift investment risks from the employer to the insurance company. The IRS has scrutinized these plans in recent years with the result being reduced deductions and penalties. It's important to consult an independent tax advisor when considering a 412(i) plan. These "fully insured" plans offer pre-retirement death benefits that are easy to calculate and plan benefits that are easier to understand.[7]

In contrast, **other defined benefit plans** provide more flexibility in both plan design and investment options. This offers the potential for high investment returns, but this entails fewer guarantees and increased risk (i.e., risk and return go hand in hand). Initial costs tend to be lower, but ongoing administrative and actuarial costs tend to be higher in comparison to 412(i) plans.[8]

Footnotes on page 279

PLAN REQUIREMENTS

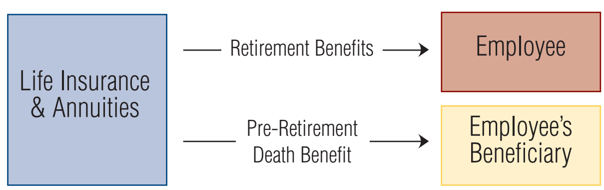
Subject to the same qualification requrements as any other defined benefit plan, including:

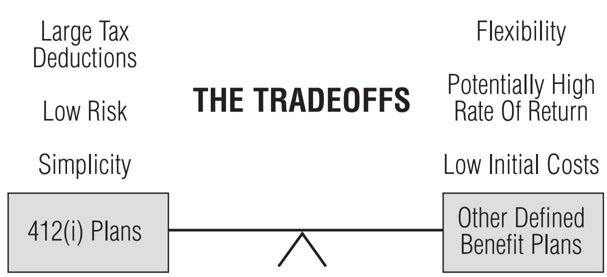
- Nondiscrimination
- Vesting
- Benefit Limits

Must also meet the following additional requirements:

- Funded exclusively by life insurance contracts and/or annuities
- Level annual premiums
- Benefits guaranteed by insurance company
- Premiums paid without lapse
- Not subject to security interests
- No policy loans

FUNDING





INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Names of employees.
2. Sex.
3. Dates of birth.
4. Dates of employment.
5. W-2 salary.
6. Hours worked per year.
7. Tax status of business (sole proprietor, C corporation, S corporation, professional corporation, partnership, limited liability company).
8. Ownership percentage.
9. Projected retirement age.
10. Other pension plans in force.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3667. Special qualification requirements that apply to defined benefit pension plans.
Q 3687. Minimum funding standard for pension plans.
Q 3734. Basic description of 412(i) plans.
Q 3735. Requirements a Section 412(i) fully insured plan must meet in order to be exempt from the minimum funding requirements.
Q 3751. Extent to which a qualified plan can provide life insurance benefits for its participants.
Q 3843. Description of the method used to determine the cost of current life insurance protection taxed to common law employee participants.
Q 3847. The cost of life insurance protection can be recovered tax free from plan benefits.
Q 3865. When employee dies *before* retirement – how beneficiary is taxed on a single sum cash payment of the death benefit.
Q 3866. When employee dies *before* retirement – how beneficiary is taxed on life income or installment payments of the death benefit.
Q 3867. When employee dies *after* retirement – how beneficiary is taxed on payments of the death benefit.

Footnotes

[1] In consolidating the funding rules of Section 412, the Pension Protection Act of 2006 eliminated Section 412(i) and moved its provisions without substantive changes to Section 412(e)(3). Although Section 412(i) no longer exists, the fully insured plans described in this chart are often still referred to as "412(i) plans."

[2] For example, the plan must generally include all full-time non-union employees, except for employees younger than 21 and those with less than one year of service. See the Qualified Plan Checklist, page 306 (but 412(i) plans are exempt from the stated "maximum limits").

[3] It is important to recognize that a defined benefit plan entails an obligation on the part of the employer to fund the plan each and every year. Failure to make regular premium payments could cause it to fail the IRS requirement that the plan be "permanent."

[4] Most 412(i) plans provide a death benefit, but it is not required. Guidance released by the IRS in 2004 announced a crackdown on 412(i) plans in three major areas: (1) **valuation of life contracts** – regulations require that a contract's fair market value be included in the distributee's income, not merely the cash value (a safe harbor definition of fair market value is provided); (2) **discrimination in the types of contracts provided to highly compensated employees** – discrimination against nonhighly compensated employees with respect to purchase or surrender rights, cash value growth terms, exchange features, or other benefits rights and features, will be considered to violate the nondiscrimination requirement; and (3) **deduction of premiums for "excessive" amounts of life insurance** – premiums attributable to excessive coverage will not be deductible, a 10 percent excise tax on nondeductible contributions may be applied, and the plan may be classified as a "listed transaction."

[5] This "incidental" death benefit requirement is also satisfied if: (1) the cost of the benefit is less than 25 percent of the cost of all benefits provided under the plan (the 25 percent rule); or (2) less than 50 percent of the employer contribution credited to each participant's account is used to purchase "ordinary life insurance" (if either *term* insurance or *universal life* insurance is purchased the 50 percent is reduced to 25 percent).

[6] This value is taxed at the lower of the Table 2001 rates (page 588) or the life insurance company's actual term rates for standard risks (beginning in 2004 the use of the insurance company's term rates was more restricted). When life insurance protection under a plan is provided by a cash value policy the aggregate costs taxed to the employee are considered to be a part of the employee's basis and may be recovered tax free from the *retirement benefits* received under the policy. Income taxation of this *death benefit* is as follows: (1) the pure insurance element (death benefit less cash values) is received free of taxes; (2) the total of "economic benefit" costs paid by participant are also received free of taxes; and (3) any remaining death benefit is taxed as a qualified plan distribution (generally as ordinary income). Qualified plan death benefits are included in the decedent's estate for estate tax purposes unless the participant avoids having any "incidents of ownership" in the policy (see page 405).

[7] If there are excess earnings they must be used to reduce future contributions that fund plan benefits. 412(i) plans also avoid both excise and income taxes on reversions to the employer, since they are fully funded by the annuity values and life insurance cash vales that determine the retirement benefit.

[8] When compared to other funding vehicles, such as variable annuities or equity investments, the question of whether the large and accelerated tax deductions produced by 412(i) plans adequately compensate for their comparatively low guaranteed rates of return is controversial. Ultimately the decision may be more influenced by a desire to: (1) fund life insurance on a tax deductible basis; and (2) avoid the risks associated with equity investments.

457 PLANS

Section 457 plans are nonqualified deferred compensation plans available to employees of state and local governments and tax-exempt organizations.[1] By deferring income, employees are able to reduce current income taxes while saving more for retirement than they would with the typical after-tax savings plan.[2]

ELIGIBLE PLANS. Under "eligible" plans, in 2015 deferrals are limited to the lesser of $18,000, or 100 percent of includable compensation.[3] Benefits usually are not subject to forfeiture. Eligible plans are most often used for the "rank and file" employees of state and local governments, who desire to defer *limited* amounts of compensation on an attractive tax deferred basis.[4] Employees of *state and local governments* are not taxed until benefits are actually paid. In contrast, employees of *tax-exempt organizations* are not taxed until the benefits are actually paid *or* otherwise made available to them. Tax-exempt organizations can only make eligible plans available to a select group of management or highly compensated employees.[5] (These higher paid employees of tax-exempt organizations often prefer "ineligible plans" providing for greater deferrals.) The *earliest* plan distributions can be made is at severance of employment, death, an "unforeseeable emergency," or in the calendar year in which the participant reaches age 70½. Plan distributions must generally begin by April 1 of the year following the year in which the employee retires or attains age 70½, whichever is later. Distributions from Section 457 plans are subject to ordinary income taxes. Rollovers are permitted to and from an eligible Section 457 plan of a state or local government, a qualified plan, a Section 403(b) tax sheltered annuity, or an IRA.

INELIGIBLE PLANS. Under "ineligible" plans, employees may make *unlimited* deferrals of compensation, provided the benefits are subject to a "substantial risk of forfeiture."[6] These plans are most often used by tax-exempt organizations to provide substantial deferrals for a *select* group of management or highly compensated employees (the "top hat" group). Use of ineligible plans by state and local governments is generally limited to highly paid employees who can accept a risk of forfeiture, since such a risk is often unacceptable to the "rank and file" employee. Because employees are taxed when there is no longer a substantial risk of forfeiture, vesting provisions must be carefully drafted.[7] Ineligible plans are not required to comply with any specific distribution requirements.

Both eligible and ineligible plans may *not* be formally funded, except for eligible governmental plans. However, it is customary and desirable for employers to "informally" fund their obligations through the purchase of life insurance, annuities, or investment products.[8] Any deferrals, and assets purchased with the deferrals, must remain the property of the employer and are subject to the employer's general creditors.

Footnotes on page 283

EMPLOYEES

of

State and Local Governments

Tax-Exempt Organizations

ELIGIBLE PLANS

- Deferrals limited to lesser of:
  $18,000
  or 100% of compensation
- Benefits not subject to forfeiture
- Coverage - State and Local Governments have no specific coverage requirements (Tax-Exempt Organizations must limit coverage to “top hat” group)
- Employee taxed when benefits actually paid or otherwise made available
- Distribution requirements:
  - seperation from service
  - unforeseeable emergency
  - age 70½

INELIGIBLE PLANS

- Deferrals unlimited
- Benefits subject to a “substantial risk of forfeiture”
- Coverage - Tax-Exempt Organizations must limit coverage to “top hat” group (State and Local Governments have no specific coverage requirements)
- Employee taxed when there is no substantial risk or forfeiture
- No distribution requirements

- May not be formally funded except for eligible governmental plans
- Deferrals subject to employer’s creditors except for eligible governmental plans

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of employee.
2. Date of birth.
3. Marital status.
4. Salary (annual, monthly, weekly).
5. Assumed current tax bracket.
6. Projected retirement age.
7. Prior and current participation in any qualified plans (including state teacher's retirement plans), 403(b) plans, and Section 457 plans.
8. Smoker/nonsmoker – when life insurance is to be used.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3567. Nonqualified deferred compensation tax benefits that are available to employees of state or local governments and other tax-exempt employers.
Q 3568. Requirements that a Section 457 plan must satisfy.
Q 3584. Taxation of cost of life insurance protection and death benefits provided under Section 457 plans.
Q 3585. Income taxation of death benefits provided under Section 457 plans.
Q 3586. Taxation of participants in eligible Section 457 plans, and "ineligible" plans.
Q 3587. Taxation of participants in "ineligible" Section 457(f) plans.

Footnotes

[1] "State and local governments" include a state, a political subdivision of a state, or any agency or instrumentality of either of them (e.g., a school district or sewage authority). Tax-exempt organizations include those types of nongovernmental organizations exempt from tax under Code Section 501 (i.e., most nonprofit organizations that serve their members or some public or charitable purpose, but not a church or synagogue). Under "eligible" plans, only individuals may participate, not partnerships or corporations. Partnerships and corporations may participate in "ineligible" plans (see footnote 5, below). Section 457 plans can also be made available to independent contractors, but under somewhat different rules.

[2] The chart on page 265 can be used to demonstrate the leverage afforded by the typical tax-favored retirement plan. Investing in a *variable* tax deferred annuity provides a particularly attractive opportunity for dollar cost averaging (see graph, page 321).

[3] The dollar limit on deferrals to a Section 457 plan is $18,000 for 2015. When appropriate, cost-of-living adjustments are made in $500 increments. This conforms to the elective deferral limits for 401(k) plans and Section 403(b) plans. "Catch-up" provisions may permit larger deferrals. See the table of Employee Benefit Limits on page 309.

[4] The term "eligible plans" is used to describe the deferred compensation plans of state and local governments and tax-exempt organizations that comply with the provisions of Section 457. When a plan provides for deferrals in *excess* of the lesser of $18,000 or 100 percent of compensation, Section 457(f) states, "compensation shall be included in the gross income of the participant or beneficiary for the 1st taxable year in which there is no substantial risk of forfeiture." Plans falling under Section 457(f) are variously referred to as "ineligible" plans and "Section 457(f)" plans.

[5] Unlike plans of state and local governments, plans of tax-exempt organizations can be subject to the participation, vesting, and funding requirements of ERISA (see page 399). These ERISA requirements are in conflict with the "no funding" requirements of Section 457 for tax-exempt organizations. This prevents most tax-exempt organizations from having a Section 457 plan unless the plan fits within the ERISA "top hat" exemption (i.e., an unfunded plan for a select group of management or highly compensated employees). This also means that "rank and file" employees of tax-exempt organizations cannot participate in Section 457 plans.

[6] A "substantial risk of forfeiture" is said to exist if a participant's right to the compensation is conditioned upon the future performance of substantial services. The risk of forfeiture must be both real and substantial.

[7] For example, payment of compensation might be conditioned upon the continued employment of the participant for a specified period, measured by a pre-established service completion date. At the end of the service completion date, when there are no longer any future service requirements, and therefore no risk of forfeiture, the deferred amount (including earnings accumulated prior to the lapse of the risk) is included in the participant's taxable income. However, the *earnings* credited to the participant's account after the substantial risk of forfeiture ends generally will not be taxable as compensation until actually paid or otherwise made available. It may be desirable to release compensation over a specific period of years in order to reduce the tax burden as the contract conditions are met.

[8] If life insurance is purchased with amounts deferred, the premiums are not taxed to the participant as long as the employer remains the owner and beneficiary of the contract. However, upon the employee's death, payment of the proceeds to the employee's beneficiary would be taxed under the normal annuity rules and would not be treated as tax-free death proceeds.

PENSION MAXIMIZATION

Upon retirement under a qualified pension plan, married workers and their spouses are often faced with making a difficult decision regarding the desired payout election.[1] Basically one of two elections may be made: (1) to take a reduced monthly income with a survivor income benefit providing for payments during the lifetimes of both the retiree and his spouse;[2] or (2) to take an increased monthly income for the lifetime of the retiree without provisions for a survivor income benefit. Although plans differ, typically when the survivor income benefit is elected there is a reduction of 25 to 30 percent.[3]

CURRENT PENSION PLAN. For example, assume that the election under the current pension plan involves a choice between a retirement benefit of $1,600 per month to both husband and wife, or $2,100 per month for the retiree only. This difference of $500 per month can be viewed as the "cost" of securing a survivor benefit for the retiree's spouse. The election must be made prior to retirement and under most plans it is irrevocable once retirement begins.[4]

The retiree and his spouse are faced with a dilemma! If the survivor income benefit is elected they will receive only $1,600 per month. And, if his spouse dies first, he will continue to receive only this reduced monthly income. On the other hand, if he elects to receive $2,100 per month and dies before his spouse, no further payments will be made to the surviving spouse.

PURCHASE OF LIFE INSURANCE can provide an alternative means of providing for the surviving spouse.[5] If life insurance is purchased upon retirement, it may be possible, depending upon the particular plan of insurance, for the increased monthly after-tax income to pay for this coverage.[6] However, it is generally better to obtain the insurance some years prior to retirement, when premiums are lower and the worker more likely to be insurable.[7] In either case, the amount of insurance should be sufficient to provide an income in replacement of the survivor benefit that was not elected.[8]

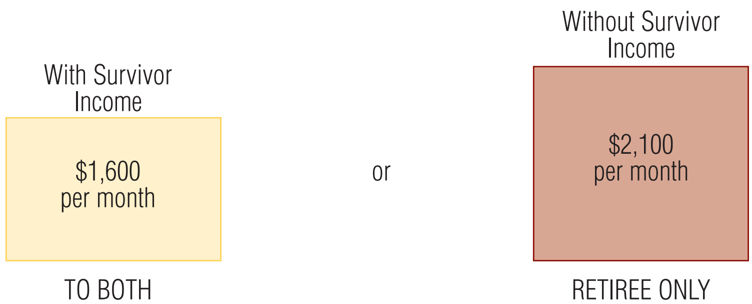
Although life insurance can be an effective way to plan around the difference in benefits between life only and survivor benefits, it is important for the retiree and his or her spouse to carefully consider the options as well as specifics of the life insurance policy being considered. You generally have only one opportunity to make your pension election.

AFTER RETIREMENT the contract insuring the retiree provides great flexibility. If the *retiree* dies first, then the death benefit can be used to pay a lifetime annuity to the surviving spouse. If the *spouse* dies first, then accumulated cash values are available to the retiree.[9] By either terminating the contract, or placing it in a "paid-up" status, the retiree could then stop premium payments and retain his full retirement income of $2,100 per month.[10]

Footnotes on page 287

CURRENT PENSION PLAN

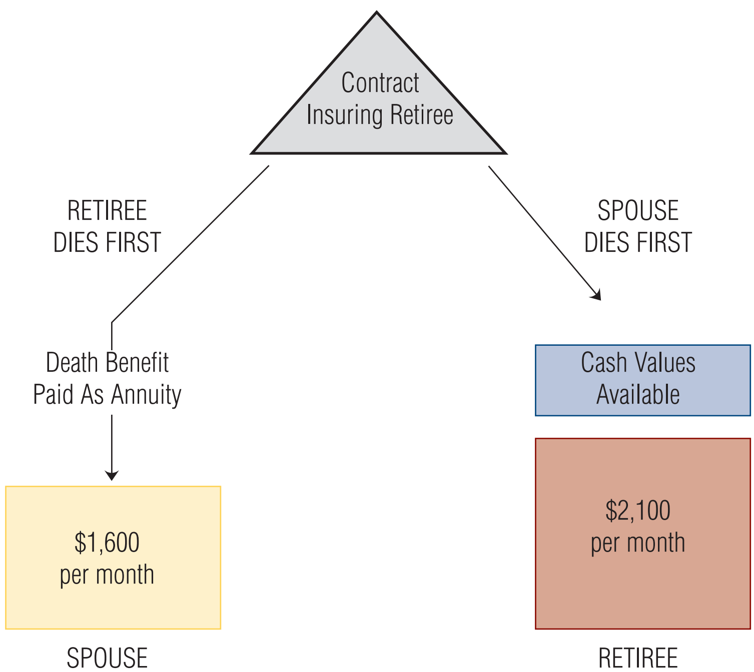
AN ELECTION



PURCHASE LIFE INSURANCE

Prior To Retirement or Upon Retirement

AFTER RETIREMENT



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Anticipated marginal tax bracket during retirement.
6. Spouse's date of birth.
7. Spouse's health.

With Regard to Current Pension Plan

8. What survivor elections are available (joint and full survivor, joint and two-thirds survivor, joint and one-half survivor, etc.)?
9. What is the monthly dollar amount payable under the preferred survivor election?
10. What is the monthly dollar amount payable if no survivor income is elected (i.e., a straight-life annuity is paid to the retiree)?
11. Does the plan provide cost-of-living increases? If so, what annual rate of increase is anticipated?
12. Does the plan require surviving spouse election in order to maintain medical benefits?

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (~~2014~~)

Q ~~226~~. Advantages of group carve-out plans.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (~~2014~~)

~~Q 3769-Q 3777~~. Forms of survivor benefits that must be provided under qualified plans and when they may be waived.

Q ~~3844~~. Taxation of employee's beneficiary on death benefit payments when employee dies after retirement.

Q ~~3845~~. Withholding of income taxes from qualified retirement plan benefits.

Footnotes

[1] "Pension maximization" is also referred to as pension maximizer, pension expander, pension trap, pension predicament, and retirement dilemma.

[2] In the chart it is assumed that survivor payments will be in the same amount as those made while both the retiree and spouse are living. This option is known as a "joint and full survivor" annuity. Another option often made available is known as a "joint and two-thirds" annuity (e.g., $2,100 per month to both husband and wife, with $1,400 per month to the survivor). In order to protect surviving spouses, the law requires that qualified pension plans must provide as a minimum a joint and one-half annuity (e.g., $1,800 per month to both husband and wife, with $900 to the survivor). The retiree's *spouse must join* with the retiree in agreeing to waive the minimum joint and survivor annuity in order to obtain the increased benefit for the life of the retiree only.

[3] The reduction will depend upon the survivor option selected. For example, if a straight-life benefit pays $2,100 per month, a joint and full survivor benefit might pay $1,600 per month, whereas a joint and one-half survivor benefit might pay $1,800 per month to both retiree and spouse and $900 per month to the survivor. Typically these options are said to be "actuarially equivalent," in that at retirement they annuitize the value of the retiree's pension benefit according to actuarial tables.

[4] Occasionally a plan may provide for reinstatement of the retiree's full benefits upon the death of his spouse. However, such a "bounce-back" provision will not recapture benefits lost prior to the spouse's death.

[5] Pension maximization may be particularly useful to the retiree who is reluctant to accept a permanently reduced retirement income to assure a survivor income to his terminally ill spouse. However, as with any pension maximization proposal, it is *absolutely essential* to ascertain whether any medical benefits would be lost to the surviving spouse if no survivor option were elected.

[6] Note that the full increase in retirement income will not be available for making premium payments, since these payments must be made with after-tax retirement dollars. On the other hand, if the surviving spouse takes an annuity payout of the tax-free death benefits, less of each payment will be subject to income tax than post-retirement survivor benefits received under a noncontributory pension plan (i.e., less death benefits will be required to provide the surviving spouse a given after-tax income).

[7] When proposed some years prior to retirement, it is appropriate to consider the time value of money, since initial premium payments will come from other than additional after-tax retirement funds. However, the pension maximization concept can be particularly useful in demonstrating the need for ongoing insurance coverage after retirement. In fact, a discussion of the concept may *demonstrate the need for permanent insurance* to a breadwinner who is considering term insurance to meet a family income need (e.g., once children are grown the same insurance can be used to provide protection for a spouse during retirement, thus there is an ongoing but different need for permanent insurance).

[8] When a plan provides cost-of-living adjustments this potential for increasing survivor income would be lost by electing an option providing for no survivor income. However, to some degree this would be offset by the increased annuity payments available to his spouse from a level death benefit (i.e., the longer the retiree lives, the older the surviving spouse; the older the surviving spouse, the larger the annuity payments from a given death benefit). Availability of an *increasing* death benefit might more than make up for such cost-of-living adjustments.

[9] If taken as a lump-sum, cash values in excess of net premiums paid would be subject to income taxation. Alternatively, the retiree might obtain additional income by exercising a settlement option under the contract by receiving existing cash values as an annuity.

[10] Maintaining the policy or taking "paid-up" insurance would preserve the death benefit for children or other heirs.

DEFERRED ANNUITY

Three things can happen to you: You can die too soon, you can become disabled, or you can live too long. The prospect of living too long requires advanced planning to assure sufficient funds are available during retirement years.[1]

Deferred annuities provide an opportunity to accumulate retirement funds on a tax-favored basis.[2] As a flexible cash accumulation vehicle, these annuities are available with either a *single* payment or *multiple* payments over a number of years (often referred to as a modal annuity). In either case, prior to the annuity starting date, the cash values of the annuity accumulate tax-deferred, with specific contractual guarantees and at competitive rates of interest.[3]

LIVE. For the annuitant who lives to retirement, the annuity can provide a guaranteed income for life. The actual amount of each payment will depend upon the values that have accumulated prior to retirement and the desired frequency of payments. When the deferred annuity matures, payments can be taken in a variety of ways, to include "full" annuity payments for the life of one person (the annuitant) or "reduced" annuity payments for the lives of the annuitant and another person (e.g., a joint and survivor annuity).

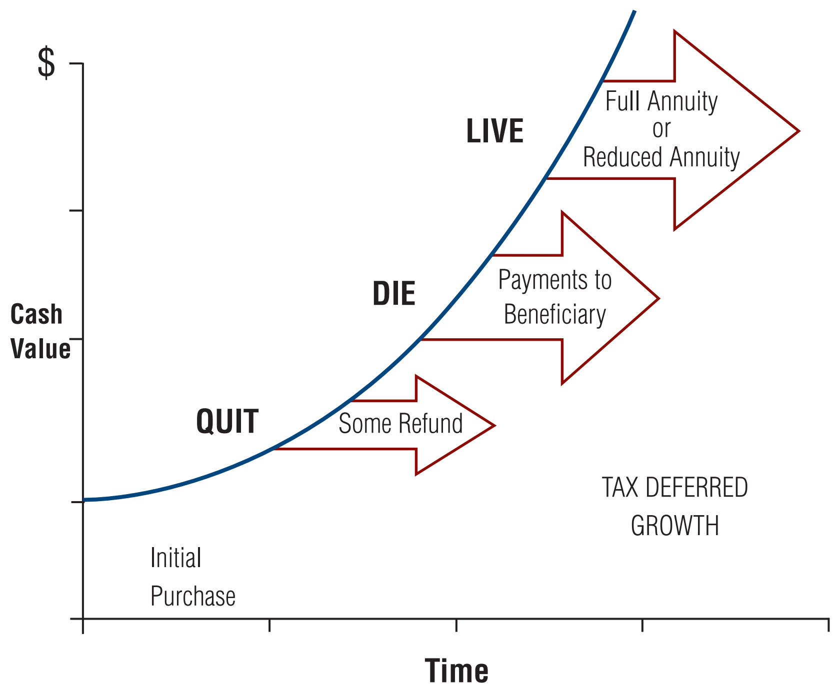
DIE. If the annuitant dies *prior* to the annuity starting date, accumulated values can be paid in a lump-sum or as an ongoing income to one or more beneficiaries. The specific amount and duration of ongoing payments depend on the particular settlement option selected.

QUIT. Should the annuitant decide to surrender the contract prior to the annuity starting date, accumulated values, minus applicable surrender charges, can be paid in a lump-sum, or applied towards a settlement option providing ongoing income payments. Before making a decision, the tax implications of each option should be carefully considered.[4]

Of course, the annuitant might die *after* the annuity starting date. To protect a surviving spouse, or other beneficiary, the annuitant can elect a settlement option providing somewhat reduced annuity payments in return for ongoing payments to a survivor. Other options are also available:

- Payments could be elected to begin prior to normal retirement age;
- Payments could be guaranteed for a minimum number of years;
- Payments could be elected for a fixed number of years.[5]

Footnotes on page 291


$
Cash
Value
LIVE
Full Annuity
or
Reduced Annuity
DIE
Payments to
Beneficiary
QUIT
Some Refund
TAX DEFERRED
GROWTH
Initial
Purchase
Time

Deferred Annuity

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of annuitant.
2. Sex.
3. Date of birth.
4. Funds available for purchase.

To Determine Suitability for Variable Product

5. Attitude toward risk.
6. Income.
7. Net worth.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 437. General rules governing taxation of annuity payments.
Q 441. Basic rule for taxing amounts received prior to annuity starting date.
Q 446. Penalties that apply to "premature" distributions under annuity contracts.
Q 516. Amount payable upon death prior to maturity subject to income taxation.

See Generally
Q 450-Q 47~~3~~. Annuity rules: fixed annuities.
Q 474-Q 478. Annuity rules: variable annuities.
Q 507-Q 5~~10~~. Gift tax annuity rules.
Q 542-Q ~~550~~. Estate tax annuity rules.

Footnotes

[1] The Penalty Of Waiting table on page 319 gives the monthly deposit required to save $100,000 by age 65, assuming 6 percent interest. The table also shows the additional savings required if there is a delay of one or 5 years in starting to save for retirement. This same concept is illustrated another way in the table entitled Early Saver vs. Late Saver on page 320.

[2] Annuities are either immediate or deferred. *Immediate* annuities, by definition, are single-premium contracts that begin paying installments immediately. (Immediate annuities are also often referred to as "income annuities.") For example, an immediate monthly annuity would begin paying to the annuitant one month after the premium was paid and the contract issued. A *deferred* annuity is one in which payments to the annuitant are delayed to a specified future date more than one payment period in the future. See also, the Annuity Matrix, page 305.

[3] Deferred annuities are also available as *variable* annuities (see the expanded discussion on page 583). With the variable annuity, the cash accumulations reflect the performance of an underlying portfolio of investments such as stocks and bonds. While these investments can provide a hedge against inflation and an increased opportunity for growth, there is also the risk that investment performance will be poor and that an annuity's value will decrease or be lost (in contrast, see the discussion of the equity-indexed annuity on pages 397-398). As an alternative to annuitization, the guaranteed minimum withdrawal benefit ensures the owner of a minimum income stream (see page 417). Since it is a security, in order to sell variable annuities you must hold a valid federal securities license and state license where required. In addition, *a prospectus must be delivered* with or preceding a proposal to a prospect or client. This chart refers to a *nonqualified* annuity, which is purchased with after-tax dollars. A *qualified* annuity is described in the chart entitled 403(b) Plans, on page 273.

[4] An early withdrawal of funds from an annuity can cause serious tax consequences. For example, taxable interest is considered to be distributed first when there is a partial withdrawal from an annuity contract purchased after August 13, 1982. This means that with such a contract a tax-free return of the amount invested in the annuity cannot be received until all accrued interest earnings have been withdrawn. If amounts are invested after August 13, 1982 in a preexisting annuity contract, amounts withdrawn are treated first as return of pre-August 14, 1982 investment, then as income on pre-August 14, 1982 investment, then as income on investment made after August 13, 1982, and finally as return of post-August 13, 1982 investment. In addition, there is a 10-percent-penalty tax applied to all taxable withdrawals from the annuity, with certain specific exceptions: such as withdrawals made after age 59½, or on account of disability, or of earnings on investment made before August 14, 1982, or as part of a series of substantially equal payments for life and not modified before age 59½ or within 60 months if modified after age 59½.

[5] These settlement options are similar to those available with most life insurance cash values.

EMPLOYEE BENEFITS CHECKLIST

Benefit	Description	Taxation of Employee
Athletic Facilities	Provided on premises and used by employees, their spouses and dependent children.	Not included in income.
Automobile	Used for business purpose.	Not included in income.
	Used for personal benefit (including travel from home to office).	Taxable as additional noncash compensation.
Cafeteria Plans	Permit employees to choose between cash and certain tax favored benefits, but not including deferred compensation other than 401(k). The plan must be written, cover only employees or former employees, and may provide benefits for beneficiaries of participants (see page 339).	A participant will not be taxed just because plan offers a choice between cash and non-taxable benefits to extent he selects nontaxable benefits. Plans are subject to special nondiscrimination rules.
Charitable Contributions	Made by employer to organizations designated by key employees.	Not included in income provided contributions made and deducted by employer.
Club Memberships	Used for business purpose or used for both business and personal purposes.	Included in income and not deductible by employee.
Conventions, Meetings and Business Trips	Attended for a business purpose.	Not included in income.
	When made primarily for a business purpose, but including a nonbusiness side trip.	Meeting and travel expenses to and from meetings are not included in income (if foreign convention, may have to prorate travel expenses).
Deferred Compensation	See chart on page 241.	Not included in income until payments actually or constructively received.
Dependent Care Expenses	Provided to employees to enable them to be gainfully employed. Employee must have at least one dependent under 13 years old or dependent or spouse who cannot care for self and resides with employee. Although plan does not have to be funded, it must be in writing.	Up to $5,000 (not more than employee's earned income, or, if less, the employee's spouse's earned income) excluded from income. Plan must meet non-discrimination and notice requirements for exclusions by highly compensated. No more than 25 percent of benefits can be paid to more-than-5 percent stockholder-employees.
Disability Income	See charts on pages 245 and 249.	Refer to table on page 326 and discussion on page 378.

Benefit	Description	Taxation of Employee
Discounts	Discounts made available to employees, spouses, and children. Discount limited to 20 percent of the selling price of a service, or the gross profit percentage multiplied by the selling price of merchandise.	Not included in income provided nondiscriminatory.
Eating Facilities	Providing subsidized meals on or near premises.	Not included in income (provided revenue employer receives equals or exceeds direct operating costs).
Educational Expenses	Reimbursed to an employee for maintaining or improving skills required in employment.	Included in income, but deductible. See table on page 313.
	Reimbursed to an employee for meeting minimum requirements for employment or qualifying for a new trade or business.	Included in income and not deductible. See table on page 313.
	Provided under a nondiscriminatory Educational Assistance Program. Education need not be job related or lead to a degree (includes graduate level courses). Covered expenses include tuition, fees, books, and supplies.	Up to $5,250 not included in income. Amounts over $5,250 are included in income and subject to employment and income tax withholding.
Executive Equity Life Insurance	See chart on page 217.	Taxable as additional compensation.
Financial Counseling & Estate Planning	Provided to key employees for personal investment and estate planning.	Included as additional wages, but deductible to the extent that they are for tax or investment counseling (subject to 2 percent floor).
401(k) Plans	See chart on page 269.	Employer contributions not included in income. Employee elective deferrals not included in income but limited to $18,000 in 2015 ($12,500 for SIMPLE 401(k) plans). Roth 401(k) elective deferrals are included in income (see page 534).
403(b) Plans	See chart on page 273.	Compensation not currently included in income (employees of public schools and colleges, and certain non-profit organizations), but generally limited to $18,000 in 2015.

References

Benefit	Description	Taxation of Employee
412(i) Plans	See chart on page 277.	Premiums paid by employer for life insurance or annuities are not included in income, but employee must include in income an amount equal to the "economic benefit" of life insurance benefit.
457 Plans	See chart on page 281.	Compensation not currently included in income (employees of state and local governments and tax-exempt organizations), but limited, in "eligible" plans to $~~18000~~ for 2015.
Gifts	Gifts to employees (but not managers, administrators, and other professional employees) if for safety or achievement.	Not included in income provided given in recognition of length of service or safety achievement. Value of award generally limited to $400.
Group Permanent Life Insurance (Section 79)	Superimposed on an existing group term plan, providing whole life insurance for employees (also referred to as "Group Ordinary Life Insurance").	Premium attributable to permanent insurance and term coverage over $50,000 are both taxable as additional compensation.
Group Term Life Insurance	See chart on page 209.	First $50,000 of coverage not included in income and amounts over $50,000 are taxable at the Table I Rates (rates, page 587). Up to $2,000 on spouse and children can be provided tax-free.
Health Savings Account	For individuals covered under high deductible health plans these accounts allow contributions by employers and employees for payment of medical expenses. Balances may be carried forward.	Contributions are deductible up to an annual contribution limit. Distributions for "qualified medical expenses" are not taxable. See chart, page 257.
Holidays	Granting time off from work on specific dates during the year. Most holidays are set, but employees may be given a number of discretionary paid holiday days.	Wages paid during holidays are included in income.
Individual 401(k) Plans	Allows owner-only small businesses, partnerships, and sole proprietors to make maximum contributions to a 401(k) plan.	Maximum of $53,000 annual additions in 2015. Employee pre-tax deferral of $18,000 (plus catch-up of $6,000 if age 50 or older). See page 424.

Benefit	Description	Taxation of Employee
Interest-Free Loans	Provided to key employees in amounts of $10,000 or less.	Not taxable and no deemed interest provided tax avoidance is not a principal purpose. If loan exceeds $10,000, employee is deemed to have income in an amount equal to foregone interest (page 429). There may be no deduction for the deemed interest payment (page 428).
IRA Contributions	Contributions to the Individual Retirement Accounts of selected key employees.	Taxation depends upon whether employee is covered by certain other plans (see pages 307 and 424).
Keogh Plans (HR-10)	These are qualified retirement plans for the self-employed. Although such individuals (sole proprietors or partners operating a trade, business, or profession) are not employees in the commonly accepted sense of the term, they are treated as "employees" for the purpose of allowing them to participate in qualified plans ("employees" include any individuals who have net earnings from self-employment in a trade or business).	Virtually no distinction is made between pension, profit sharing, and other retirement plans established by the self-employed and those established by corporations.
Legal Expense Benefit	Providing legal services to employees for a variety of legal matters. Most plans offer scheduled benefits provided by a specified group of lawyers.	Benefits should be received tax-free. If employer pays "premiums" on employee's behalf, employee must include that amount in income. See discussion on page 433.
Meals and Lodging	Provided *on* the employer's premises and "for the convenience of the employer." There must also be a "substantial noncompensatory business reason." Acceptance of lodging must be a condition of employment.	Not included in income.
	Provided *off* the employer's premises while the employee is traveling to and attending a business convention or meeting, or on a business trip.	Not included in income.
Medical Benefits (continued on next page)	Providing hospitalization, surgical and major medical expenses for employees and their dependents.	Not included in income. Non-discrimination requirements apply to self-insured plans.

References

Benefit	Description	Taxation of Employee
Medical Benefits (continued)	Providing reimbursement for medical, dental, and drug expenses (usually expenses not covered under a group plan). See chart on page 253.	Not included in income. Non-discrimination requirements apply to self-insured plans.
Medical or Physical Examinations	Made available on a periodic basis to executives and key employees, including blood tests and x-rays.	Not included in income. In discriminatory self-insured plan, included in income if for specific illness or symptom.
Moving Expenses to New Principal Place of Work	Reimbursed to an employee for *direct* expenses, including moving household goods, cars, and family, as well as *indirect* expenses such as pre-move house hunting trips, temporary living expenses while waiting to move into a new home and certain expenses of selling, purchasing, and leasing an old home or new home.	*Direct* expenses are included in income but deductible from gross income, provided requirements as to length of service and distance from former home are met. *Indirect* expenses are included in income and are not deductible by employee.
Parking	Provided to an employee on or near the business premises or on or near a location from which the employee commutes to work by mass transit, in a commuter highway vehicle, or by carpool.	May exclude from gross income up to $250 per month for value of employer-provided qualified parking in ~~2014~~.
Pension Plans	Providing guaranteed retirement benefits to employees based upon a nondiscriminatory formula or formulas. Such formulas utilize either a defined benefit or a defined contribution approach (e.g., either a specific dollar benefit to the employee at retirement, or a specific dollar contribution each year by the employer).	Employer contributions not included in income until payments received. If the plan contains insurance, each employee reports the value of coverage using Table 2001 rates as set forth on page 588. See discussions on pages 344, 374, 484, and 519.
Per Diem	Paid to employees as a fixed reimbursement for subsistence items such as meals, lodging, laundry, tips, etc., while on business trips.	Rate authorized to be paid by the federal government for the area in which the travel is authorized may be excluded from income, as well as an additional amount per mile for transportation expenses.
Professional Dues and Publications	Paid by an employer for the benefit of key employees.	Usually taxable as additional compensation, but deductible by the employee as a miscellaneous itemized deduction (subject to 2 percent floor).

Benefit	Description	Taxation of Employee
Profit Sharing Plans	Providing retirement benefits based upon a nondiscriminatory formula for allocating contributions among participants. There is no requirement to have a predetermined formula for calculating contributions (permissible maximum employer deduction is generally 25 percent of total compensation of plan participants).	Employer contributions not included in income until payments received, and payments are then subject to favorable tax treatment. See discussions on pages 333, 512, 519, and 562..
Retired Lives Reserves (RLR)	See discussion on page 529.	Contributions not currently taxed; after retirement, cost of coverage is taxable in year provided.
Sabbaticals	Allowing key executives to undertake independent work and study for periods of 3 to 12 months. The expected benefits are expanded horizons, life-goal reassessments, and renewed commitment to job performance.	Wages paid during sabbaticals are considered income.
Salary Allotment Plans	See chart on page 213.	Employee allotments come from after-tax income.
Salary Deferral SEP (SAR-SEP)	New plans may not be established after 1996. These plans were established by employers with 25 or fewer employees (at least 50 percent of employees must participate). Contributions to existing plans are made on a cash or deferred basis. In 2015 the maximum annual employee elective deferral is $18,000, plus $6,000 catch-up if over age 50.	Employee elective deferrals are not included in income. Employer nonelective and matching contributions are also not included in the employee's income. Distributions are subject to the same rules as IRAs. Nondiscrimination rules apply. See discussion on page 555.
Sick Leave	Paid to employees while absent from work due to sickness or accident.	Amounts paid are included in income. A tax credit is available if the employee is permanently and totally disabled (page 378).
SIMPLE IRA	A simplified tax-favored retirement plan for small employers providing for elective contributions by employees. Within limits, employer can match employee contributions.	Both employee and employer contributions are not included in income until payments are received. See discussion on page 554.

References

Benefit	Description	Taxation of Employee
Simplified Employee Pension (SEP)	Providing for employer contributions to the employee's IRA on a nondiscriminatory basis and under a written allocation formula. See discussion on page 555.	Employee may exclude up to lesser of 25 percent of compensation or $53,000 in 2015.
Social Security	Contributions to the Old-Age, Survivors, and Disability Insurance programs (FICA taxes). Refer to pages 314-315.	Employer contributions not included in income. However, retirement and disability payments may be partially or fully taxed (see page 556).
Split-Dollar Insurance	See chart on page 229.	Value of employer-provided coverage is taxable as additional compensation See chart on page 229 and discussion on page 394.
Split-Dollar Rollout	See discussion on page 558.	Generally included in income to extent of policy's interpolated terminal reserve, roughly equivalent to the cash values. Not taxed if converted to a loan under two-regime taxation of split-dollar (see page 558).
Stock Options – Incentive	Granted to key executives under a plan specifying the number of shares to be offered and the employees to be included. Certain requirements must be met, but stockholder-employees can be issued options (if more than 10 percent of stock is owned, additional limitations are imposed). See discussion on page 420.	When option is exercised, no tax is paid, even on bargain element (i.e., the difference between the exercise price and the stock's value at time of exercise) if holding period and employment requirements are met. Sale of stock by the employee results in capital gain.
Stock Options – Nonqualified	May be granted to key executives, including stockholder-employees, with virtually no IRS imposed restrictions regarding time within which they must be exercised, exercise price, or period stock must be held before sale (also known as "nonstatutory stock options"). See discussion on page 491.	When option is granted, no tax is paid provided option does not have an ascertainable fair market value (closely held stock). When option is exercised, the spread between the option price and market value, at the time of exercise, is taxed as ordinary income (at same time company gets deduction).

Benefit	Description	Taxation of Employee
Stock Options – Phantom	Providing selected employees a form of deferred compensation by awarding "units of participation." Each unit is equivalent to a share of stock. As the stock appreciates, so do the participation units. On retirement, the employee receives appreciation that occurred in the comparable stock, plus previously credited dividend equivalents. Also known as phantom stock plans (see discussion on page 501).	Not included in income until payments actually received for participation units and dividend equivalents, at which time all payments would be taxed as ordinary income, not as capital gains. Employee must have no rights in units. Could be used by S corporation without creating a second class of stock.
Stock Ownership Plan (ESOP)	Established on a nondiscriminatory basis, covering a wide range of employees. Stock is currently contributed to a trust to be eventually distributed to retiring employees. Not practical unless corporate payroll is at least $500,000 and the owner has a real desire to eventually transfer ownership to employees.	Not included in income at time the stock is contributed to trust. Taxable as ordinary income when the stock, or cash payment for stock, is transferred to the employee upon retirement. However, taxation may be deferred if the distribution is an "eligible rollover distribution." See discussion on pages 391-392.
Stock Purchase Plan	Providing employees the opportunity to purchase limited amounts of stock at a discount from fair market value. Purchases cannot be made by employees owning 5 percent or more of the voting control or value of all classes of stock.	Purchase is made with after-tax dollars. Subsequent appreciation will qualify as capital gain on sale if certain holding period and employment requirements are met.
Supper Money	Paid to employees who voluntarily stay overtime, when furnished for the employer's convenience.	Not included in income.
Survivor Income Benefit Plan	See chart on page 237.	Pre-death "informal" funding of plan by employer is not included in employee's income. Benefits received by surviving family are taxable income.

References

Benefit	Description	Taxation of Employee
Thrift Plans	Permit employees to make contributions to a pension, profit sharing, or stock bonus plan. The employer's contributions are usually geared to the amount or rate of the employee's contributions. Both employer and employee contributions are limited by nondiscrimination requirements.	Employee contributions are made with after-tax dollars. Employer contributions are not included in income until withdrawn from the plan. All accruals are tax-deferred. See discussion on page 542.
Transportation	Provided to an employee in the form of transit passes or vanpooling in a "commuter highway vehicle."	May exclude from gross income a maximum of $130 per month in value of employer-provided qualified transportation in ~~2014~~.
Travel Accident Life Insurance	Provided to employees and covering accidental death while traveling on company business. Other variations can provide 24-hour accident coverage on and off the job.	Not included in income.
Unemployment Compensation	Benefits paid to unemployed workers who were previously employed by contributors to the system.	Included in income (also subject to substantial downward adjustments depending upon other income).
Vacation Travel	Combined with a trip made "primarily" for business purposes.	Business expenses including travel to and from business meetings are not taxable. Expenses associated with vacation would be taxable.
Vacations	Providing a paid rest from work and usually based upon years of service.	Wages paid during vacations are included in income.
Worker's Compensation	Providing both medical expense and direct payments to workers injured on the job, as well as survivors of workers who are killed on the job.	Premiums paid by employer and benefits received are not included in income.

EMPLOYER/EMPLOYEE SPLIT-DOLLAR PLANS

In light of Notice 2002-8 & Final Regulations

<table>
<tr><th colspan="3">Table A - Plans Entered Into Before January 28, 2002</th></tr>
<tr><th></th><th>Taxation of Cash Values</th><th>Economic Benefit</th></tr>
<tr><td>Plan Terminated
Before January 1, 2004</td><td>SH1: Employee not taxed on cash value in excess of employer's interest (referred to as the rollout safe harbor). See Planning Point 1, bottom page 302.</td><td>n/a</td></tr>
<tr><td rowspan="3">Plan Terminated
On Or After
January 1, 2004</td><td>SH2: Employee not taxed on equity if plan converted to a loan from employer to employee for all periods beginning January 1, 2004 (pre-2004 employer outlays considered beginning loan balance, and subsequent employer premiums added to loan balance). After conversion to a loan there is no reportable economic benefit.</td><td rowspan="5">1. Use insurer's published term premium rates, or

2. Until further IRS guidance use Table 2001 rates as first set forth in Notice 2001-10, or

3. If specified by split-dollar agreement, may use P.S. 58 rates.</td></tr>
<tr><td>SH3: Employee taxed on existing employee equity if plan converted to a loan on or after January 1, 2004. However, employee not taxed on equity accruing after conversion.</td></tr>
<tr><td>Upon termination employee subject to being taxed on all equity if plan not previously converted to a loan from employer to employee. Would have to rely on interpretation of prior split-dollar rulings (i.e., Revenue rulings, Technical Advice Memorandums, Private Letter Rulings, etc.). Under no inference language of Notice 2002-8 would ignore Notice 2001-10 And Notice 2002-8.</td></tr>
<tr><td rowspan="2">Plan Not Terminated
(and not materially modified)</td><td>SH4: Employee not taxed on equity provided the employee continues to report the receipt of the economic benefit and the employer retains some economic interest</td></tr>
<tr><td>SH5: Employee not currently taxed on equity merely because cash surrender value exceeds the amount payable to employer.</td></tr>
<tr><td colspan="3">SH1: This safe harbor (SH) provides that, as long as the employer is entitled to receive full repayment of premiums, if plans entered into before January 28, 2002, are terminated before January 1, 2004, (i.e., are rolled out) the IRS will not assert that there is a taxable transfer (under Section 83). Interestingly, this appears to apply to endorsement plans as well as collateral assignment plans.</td></tr>
<tr><td colspan="3">SH2-SH5: See bottom of page 302.</td></tr>
</table>

References

EMPLOYER/EMPLOYEE SPLIT-DOLLAR PLANS (cont'd)

<table>
<tr><td colspan="3">Table B - Plans Entered Into After January 28, 2002 & Before September 18, 2003</td></tr>
<tr><td></td><td>Taxation of Cash Values</td><td>Economic Benefit</td></tr>
<tr><td rowspan="2">Plan Terminated</td><td>SH3: If plan converted to a loan emplyee not taxed on equity accruing after conversion. However, any existing emplyee equity at time of conversion would be taxable. See Planning Point 2, bottom page 303.</td><td>n/a</td></tr>
<tr><td>Employee subject to being taxed on all equity if plan not coverted to a loan. Would have to rely on imterpretation of prior split-dollar rulings (i.e., Revenue Rulings, Technical Advice Memorandums, Private Letter Rulings, etc.). According to the no inference language of Notice 2002-8 would not consider Notices 2001-10 and 2002-8.</td><td rowspan="3">1. Use insurer's published premiums rates, but for periods after December 31, 2003, insurer must actually make known and sell term insurance at these rates, or

2. Until further IRS guidance use Table 2001 rates as first set forth in Notice 2001-10.</td></tr>
<tr><td rowspan="2">Plan Not Terminated
(and not materially modified)</td><td>SH4: Employee not taxed on equity provided the employee continues to report the receipt of the economic benefit and the employer retains some economic interest.</td></tr>
<tr><td>SH5: Employee not currently taxed on equity merely because cash surrender value exceeds the amount payable to employer.</td></tr>
<tr><td colspan="3">SH2: This safe harbor provides that, as long as the employer is entitled to receive full repayment of premiums, if the plan is converted to loan treatment the IRS will not assert that there is a taxable transfer (under Section 83) upon eventual termination.</td></tr>
<tr><td colspan="3">SH3: This safe harbor allows taxation under the Loan Regime (see Table C, page 303).</td></tr>
<tr><td colspan="3">SH4: This safe harbor provides that, as long as the plan is maintained by having the employee continue to report the economic benefit, the IRS will not challenge the arrangement as terminated (with resulting transfer of equity to employee).</td></tr>
<tr><td colspan="3">SH5: This safe harbor provides that there will be no deemed transfer under Section 83 of a portion of the cash surrender value that exceeds the amount payable to the employer.</td></tr>
</table>

EMPLOYER/EMPLOYEE SPLIT-DOLLAR PLANS (cont'd)

Table C - Plans Entered Into *After* September 17, 2003

Plan Structured As	Taxation of Cash Values	Economic Benefit
Economic Benefit Regime: *emplyer* owns policy (endorsement method).	Employee *taxed* on annual increase in value (not just at rollout). This is likely to present a difficult problem of valuation, particularly, regarding variable life. Employee *taxed* on equity upon transfer of policy from employer to employee (i.e., when there is a "rollout"). But "taxable equity" is reduced by amounts paid at time of transer and amounts of equity previously included in employee's income.	According to final regulations the IRS will issue new "life insurance premium factors." Until then, use Table 2001 rates as first set forth in Notice 2001-10.
Loan Regime: *employee* owns policy (collateral assignment method).	Employee *not taxed* on equity (i.e., employee owns the policy, is obligated to repay the employer, and the policy is subject to the employer's security interest for loans made to employee). Note: if employee owns policy, but employer is entitled to all cash values (a non-equity collateral assignment arrangement), the IRS will treat it as employer-owned under the economic benefit regime. See Planning Point 3.	n/a (all employer outlays are treated as loans to employee)

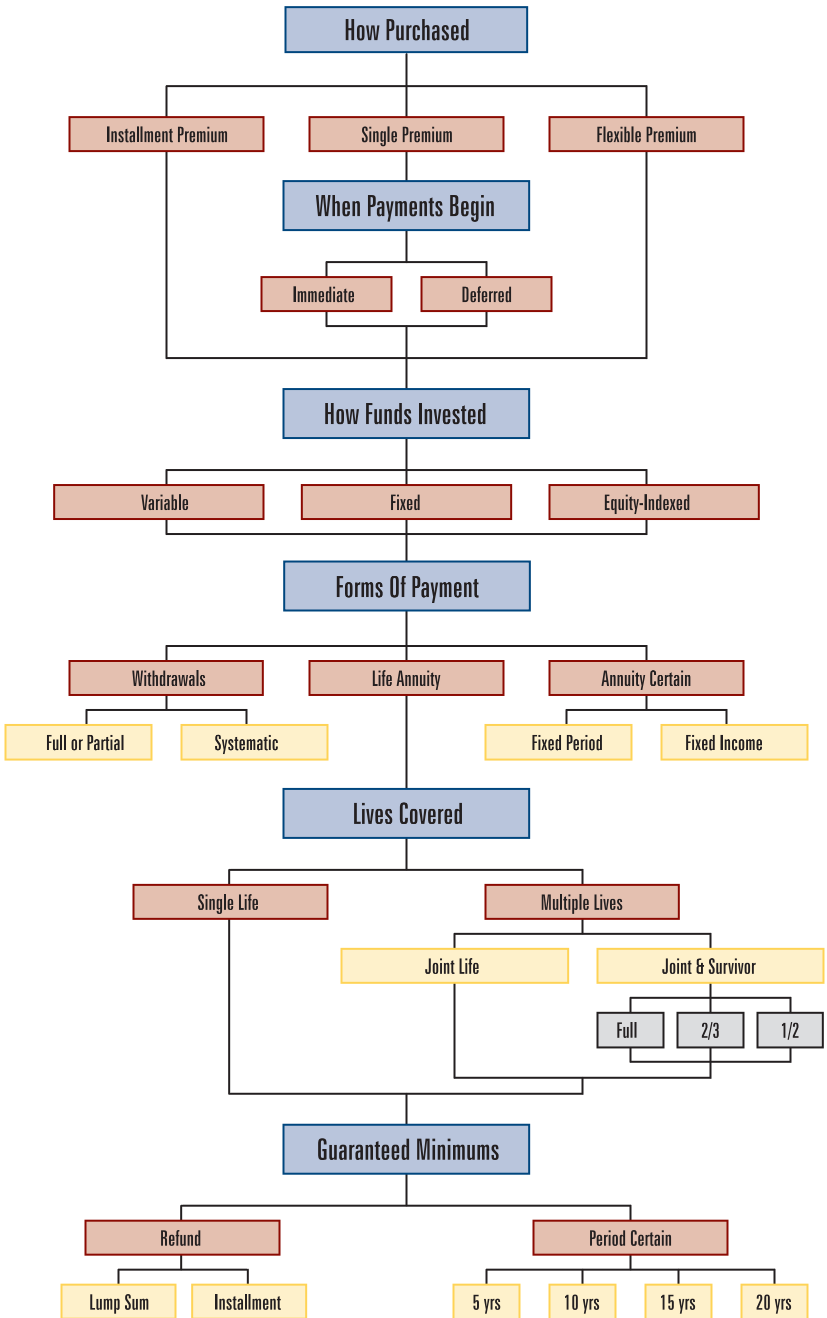
Planning Point 2: In order to secure potentially lower economic benefit reporting (as opposed to assumed higher cost of loan interest) a plan might be established under SH4 and SH5 as collateral assignment split-dollar until such time as the employee is about to acquire an equity interest (employee equity = cash value - employer interest - employee basis, if any). At that time the plan could be switched to SH3 (referred to as "switch dollar"). This would avoid taxation of any employee interest at time of switch (i.e., none exists) and avoid taxation of future employee equity interests (unless cash value withdrawals exceed employee's basis). Also, might consider switching to SH3 if cost of economic benefit exceeds cost of nondeductible loan interest (i.e., the crossover point).

Planning Point 3: This could be useful in *controlling stockholder* situations when using a limited collateral assignment to keep corporate employer from having prohibited incidents of ownership (see Controlling Stockholder, page 362).

SPLIT-DOLLAR – APPLICABLE CODE SECTIONS

Code Section	Relates To	Used In Reference To
61	Taxation of **all income** rom whatever source derived (a catch-all provision).	Valuation of life insurance protection under the economic benefit principle (annual economic benefit measured by Table 2001 rates).
83	Taxation of **property transferred** in connection with the performance of services (this approach not taken in final regulations).	Transfer of an existing policy from the employer to the employee, to include partial transfers of interests in policy cash values. Concept of "deemed transfer."
1271-1275	Taxation of **original issue discount** loans.	These sections would only be applicable if: 1. Loan is subject to Section 7872 because no or an inadequate rate of interest is charged, <u>and</u> 2. Loan is considered a *term* loan under Section 7872, therefore deemed payment to employer treated as original issue discount (not applicable to employment-related *demand* loans payable upon termination of employment).
7872	Taxation of **below market interest** loans.	Imputing interest when loans charge no interest, or if interest is charged at less than the appropriate applicable federal rate (AFR). But interest-bearing loans at the appropriate AFR are not taxed under the imputed interest rules of Section 7872.

ANNUITY MATRIX



QUALIFIED PLANS CHECKLIST

Element	Limitation
Maximum limits.	**Defined Benefit Plan**: Benefits are limited to the lesser of 100% of pay, or $210,000 (as indexed for 2015). **Defined Contribution Plan**: The annual additions limit is the lesser of 100% of salary, or $53,000 (as indexed for 2015). In a profit sharing plan the total annual employer deduction is 25% of total compensation of plan participants. **401(k) Plans (traditional or safe harbor)**: During calendar year 2015, the allowable employee deferral is $18,000 (during 2015 participants who are age 50 or over may be permitted to make additional catch-up contributions of $6,000). SIMPLE 401(k) plans are limited in 2015 to $12,500 elective deferrals and $~~3000~~ catch-up.
Eligibility to participate.	Exclusions are permitted for age and years of service (maximum of age 21 and 1 year service).
Integration with Social Security.	A plan integrated with Social Security will often permit significantly higher benefits for higher paid employees within certain limits. Defined *contribution* plans may provide additional contributions of up to 5.7% of pay in excess of current Social Security wage base ($118,500 in 2015). Defined *benefit* plans may provide additional monthly benefits of up to the lesser of .75% of earnings, or the base benefit percentage for the plan year. In either type of plan the percentage of total contributions/benefits for those above the "integration level" may not be more than two times the percentage of contributions/benefits below that level. In addition, the disparity between the two percentages must be uniform with respect to all participants. If additional requirements are met, the "integration level" may be lower than the Social Security wage base.
Employee vesting.	Employer contributions need not become immediately and irrevocably vested, but may be contingent upon continued employment. Thus, costs to the employer may be reduced or benefits increased for employees who continue their employment. "Top-heavy" plans, and certain employer match contributions, are subject to special rapid vesting rules.

Element	Limitation
Definition of a "top heavy" plan.	A plan is top heavy if for "key employees" the present value of accrued benefits in a defined *benefit* plan or account balances in a defined *contribution* plan exceeds 60% of accrued benefits or account balances for all employees. Key employees include: (1) officers earning more than $170,000 (as indexed for 2015), (2) any 5% owner of the employer, and (3) any 1% owner who earns more than $150,000 per year.
For top-heavy plan purposes, definition of the term "officer."	The term "officer" has a very special meaning. Officers of any employer include no more than either: (1) 50 employees; or, if *less*, (2) the greater of 3 employees or 10% of the employee group. In other words, the maximum number of employees considered officers is 10% of the employee group, up to 50.
Fund investment flexibility.	Trustee may direct the investments into nearly any type of investment media. Strict fiduciary standards apply.
Distributions.	Generally, distributions to a non-5%-owner must be started by April 1 of the year following the year the individual attains age 70½ or retires, whichever is later. Distributions to a 5%-owner cannot be delayed until retirement.
Premature distributions.	Distributions prior to age 59½ will be subject to a 10% penalty tax (25% during first two years with SIMPLE IRA) unless distribution is due to death, disability, separation from service after age 55, or in the event of certain specified hardships. The penalty tax is also waived if the distribution is annuitized or to the extent needed to pay family medical expenses in excess of 7½% of adjusted gross income.
Federal estate tax status of death benefits.	Fully included in estate.
Availability of $5,500 IRA deduction (in 2015).	*Not* available if covered by pension, profit sharing or stock bonus plan, a 403(b) plan, a SIMPLE IRA, a SEP, or a government plan and adjusted gross income in 2015 exceeds: (1) $71,000 – individual return (2) $118,000 – joint return *Partially* deductible if covered by plan (listed above) and adjusted gross income ranges from: (1) $61,000-$71,000 – individual return. (2) $98,000-$118,000 – joint return *Fully* available if not covered by listed plan. See discussions on page 424 and page 535.

401(k) PLAN DESIGNS

Traditional 401(k) Plan

Maximum salary deferral is $18,000 in 2015, plus $6,000 if age 50 or over.

Employer can sponsor other qualified retirement plans.

Employer contribution is not required. Overall maximum contribution per employee limited to 100% of compensation and not to exceed $53,000 in 2015.

Graduated vesting allowed on employer contributions, but immediate vesting required on employee contributions.

Subject to both ADP/ACP tests and top heavy rules.

See also, chart on page 271.

Safe Harbor 401(k) Plan

Maximum salary deferral is $18,000 in 2015, plus $6,000 if age 50 or over.

Employer can sponsor other qualified retirement plans.

Employer contribution is required, either:

- 100% on first 3% of employee deferral, plus 50% of next 2% of employee deferral (total of 4%), or
- 3% of compensation to all eligible employees (i.e., nonelective).

Immediate vesting is required.

Deemed to satisfy ADP/ACP tests and generally not subject to top heavy rules.

SIMPLE 401(k) Plan

Maximum salary deferral is $12,500 in 2015, plus $3,000 if age 50 or over.

Employer cannot sponsor other qualified retirement plans. Employer limited to 100 or fewer eligible employees.

Employer contribution is required, either:

- 100% on up to 3% of employee's compensation, or
- 2% of compensation to all eligible employees (i.e., nonelective).

Immediate vesting is required.

Deemed to satisfy ADP/ACP tests and not subject to top heavy rules.

Automatic Enrollment Safe Harbor 401(k) Plan

(available for plan years beginning on or after January 1, 2008)

Default elective deferral must be at least 3% the 1st year, 4% the 2nd year, 5% the 3rd year, and 6% the 4th year (not to exceed 10% in any year).

Employer contribution is required, either:

- 100% on first 1% of compensation, plus 50% on next 5% (maximum of 3½%), or
- 3% of compensation to all eligible employees (i.e., nonelective).

Vesting after two years of service is allowed on employer contributions.

Deemed to satisfy ADP/ACP tests and not subject to top-heavy rules.

- **Roth 401(k) Feature**
  1. This is a separate account to which after-tax contributions may be designated.
  2. Distributions are potentially tax-free, if certain requirements are met.
  3. Subject to the same salary deferral limit as overall plan.
  4. See also, discussion on page 534.
- **Individual 401(k) Plan**
  1. Also referred to as a solo or mini-401(k) plan.
  2. This is a single-participant profit sharing plan with 401(k) features (the name itself has been created by the marketplace, it is not found in the Code).
  3. Requirements depend on which of the four designs above is used.
  4. See also, discussion on page 423.

EMPLOYEE BENEFIT LIMITS

	Year			
Type of Limit	2012	2013	2014	2015
Defined Benefit Section 415	200,000	205,000	210,000[1]	210,000
Defined Contribution Section 415	50,000 or 100% of salary	51,000 or 100% of salary	52,000[2] or 100% of salary	53,000 or 100% of salary
Elective Deferral for traditional and safe harbor 401(k) Plans, 403(b) Plans (TDAs), & SEPs	17,000	17,500	17,500[3]	18,000
Catch-Up for traditional and safe harbor 401(k) Plans (age 50 and over)[4]	5,500	5,500	5,500[3]	6,000
Catch-Up for 403(b) Plans (TDAs)[4]				
age 50 and over	5,500	5,500	5,500[3]	6,000
15 years of service	3,000	3,000	3,000	3,000
Elective Deferral Limit for Section 457	17,000	17,500	17,500[4]	18,000
Catch-Up for Section 457 Plans - age 50 and over[4]				
other than last 3 years before retirement[5]	5,500	5,500	5,500[3]	6,000
during last 3 years before retirement	17,000	17,500	17,500[3]	18,000
Elective Deferral Limit for SIMPLE IRAs and SIMPLE 401(k) Plans	11,500	12,000	12,000	12,500
Catch-Up for SIMPLE IRAs and SIMPLE 401(k) Plans[4]	2,500	2,500	2,500[3]	3,000
Highly Compensated Employee Definitional Limit	115,000	115,000	117,000[1]	120,000
Maximum Compensation for Qualified Plans, SEPs, TSAs, & VEBAs	250,000	255,000	260,000[1]	265,000

1 Subject to indexing in $5,000 increments.
2 Subject to indexing in $1,000 increments.
3 Subject to indexing in $500 increments.
4 Catch-up amounts are in addition to the elective deferral limit.
5 Use the participant's compensation, reduced by any other elective deferrals made that year, if less than the applicable dollar amount shown in the table.

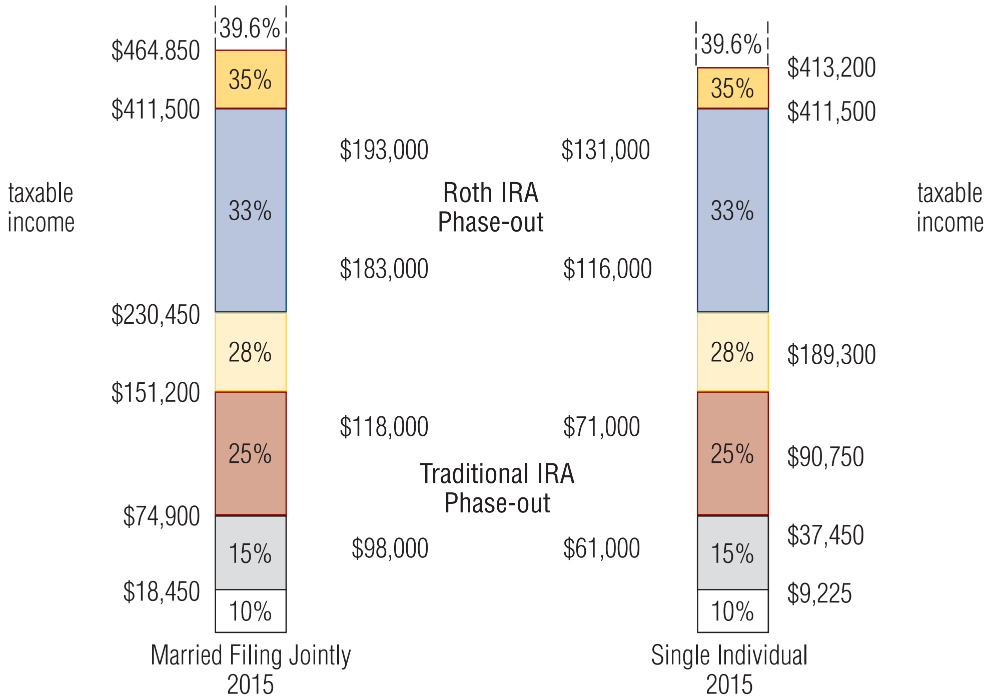
THE IRA SPECTRUM

Type	Eligibility for Plan	Limits on Contributions[1]	Deductible	Tax Advantages	Withdrawals/Distributions
Roth (page 535)	Individual: In 2015 AGI[2] less than $131,000 (phase-out $116,000-$131,000) Married filing jointly: In 2015 AGI[2] less than $193,000 (phase-out $183,000-$193,000)	Individual: $5,500. Married filing jointly: $11,000. Contributions allowed after age 70½. Catch-up for individuals who have reached age 50 is $1,000.	No	Tax-free earnings. Early withdrawals of contributions tax-free and penalty-free.	Tax-free if after 5 years and: after age 59½, for first home, disability, or upon death. Distribution *not* required at age 70½.
Traditional - deductible (page 424)	Not active participant in employer-sponsored retirement plan, or Individual: In 2015 AGI[2] less than $71,000 (phase-out $61,000-$71,000). Married filing jointly: In 2015 AGI[2] less than $118,000 (phase-out $98,000-$118,000).	Individual: $5,500. Married filing jointly: $11,000. Contributions *not* allowed after age 70½. Catch-up for individuals who have reached age 50 is $1,000.	Yes	Tax-deferred earnings, but taxable upon withdrawal.	Penalty-free if after age 59½, for first home, higher education, or upon death. Distribution required at age 70½.
SIMPLE (page 554)	Self-employed or employed by company with 100 employees or less.	Employer: 3% matching or 2% non-elective. Employee: $12,500. Catch-up for individuals who have reached age 50 is $3,000.	Contributions are before taxes.	Tax-deferred earnings, but withdrawals taxable.	Distribution required at age 70½.
SEP (page 555)	Self-employed or employed by sponsoring employer.	Up to 25% of employees salary or $53,000 maximum. See also SEP-IRA, page 555.	Contributions are before taxes.	Tax-deferred earnings, but withdrawals taxable.	Distribution required at age 70½.

[1] Combined annual contributions to both Roth IRA and Traditional IRA are limited to $5,500 (effectively, $11,000 for a married couple).

[2] AGI stands for adjusted gross income.

WHICH IRA — ROTH OR TRADITIONAL?



A Roth IRA offers the following potential advantages: (1) distributions are not required at age 70½; (2) contributions may continue after reaching age 70½; (3) phaseout limits are higher than those for deductible contributions to a Traditional IRA; and (4) tax-free retirement distributions will not push modified adjusted gross income above the threshold that triggers taxation of Social Security benefits (see page 556). This analysis focuses on after-tax accumulations and requires assumptions regarding tax rates prior to and after retirement (the above chart may help).

Assuming the **same** tax rate prior to and after retirement: (1) there is no difference between the after-tax distributions from a Roth IRA and a Traditional IRA if all funds can be deposited in a Traditional IRA, or other tax deductible fund (see Table A, page 312); (2) the Roth IRA offers the advantage of larger after-tax distributions if before-tax funds exceed the $5,500 limit that can be deposited in a Traditional IRA and the excess must be placed in a nondeductible side fund (see Table B, page 312). Further, the Roth IRA advantage increases if the side fund earnings are currently taxed.

Assuming a **lower** tax rate after retirement, the Traditional IRA generally provides larger after-tax distributions (i.e., 25 percent prior to retirement and 15 percent after retirement). For active participants, no comparison need be made assuming a tax rate higher than 25 percent since deductible contributions to a Traditional IRA are phased out before reaching the 28 percent tax rate (i.e., no deduction is allowed in 2015 for "married filing jointly" once modified adjusted gross income exceeds $118,000 and for a "single individual" once modified adjusted gross income exceeds $71,000). Note that marginal tax rates in the above chart vary according to *taxable income*, whereas IRA contributions are phased out according to *modified adjusted gross income* (see pages 307, 310, 424, 535, and 548). Taxable income is equal to adjusted gross income less deductions and personal exemptions.

Assuming a **higher** tax rate after retirement, the Roth IRA provides larger after-tax distributions (e.g., 25 percent prior to retirement and 28 percent after retirement).

WHICH IRA — ROTH OR TRADITIONAL? (continued)

Table A – This table assumes an 8 percent interest rate and 25 percent tax rate. The nondeductible Roth IRA deposit requires $1,333 before taxes (1,000/(1 - .25) = 1,333). This is the same as making a deductible deposit of $1,333 to a Traditional IRA. There is no Roth IRA advantage.

	Roth IRA			Traditional IRA		
Year	**Deposit**	**Plus Interest**	**Value**	**Deposit**	**Plus Interest**	**Value**
1	1,000	80	1,080	1,333	107	1,440
2	1,000	166	2,246	1,333	222	2,995
3	1,000	260	3,506	1,333	346	4,675
4	1,000	360	4,867	1,333	481	6,489
5	1,000	469	6,336	1,333	626	8,448
6	1,000	587	7,923	1,333	782	10,564
7	1,000	714	9,637	1,333	952	12,849
8	1,000	851	11,488	1,333	1,135	15,317
9	1,000	999	13,487	1,333	1,332	17,982
10	1,000	1,159	15,645	1,333	1,545	20,861
11	1,000	1,332	17,977	1,333	1,776	23,970
12	1,000	1,518	20,495	1,333	2,024	27,327
13	1,000	1,720	23,215	1,333	2,293	30,953
14	1,000	1,937	26,152	1,333	2,583	34,869
15	1,000	2,172	29,324	1,333	2,896	39,099
16	1,000	2,426	32,750	1,333	3,235	43,667
17	1,000	2,700	36,450	1,333	3,600	48,600
18	1,000	2,996	40,446	1,333	3,995	53,928
19	1,000	3,316	44,762	1,333	4,421	59,683
20	1,000	3,661	49,423	1,333	4,881	65,897
Less Taxes			0			16,474
Net Distribution			49,423			49,423

Table B – This table assumes an 8 percent interest rate and 25 percent tax rate. The nondeductible Roth IRA deposit requires $7,333 before taxes (5,500/(1 – .25) = 7,333). This is the same as making a deductible deposit of $5,500 to a Traditional IRA *plus* a nondeductible deposit of $1,375 to a Side Fund (5,500 + 1,375/(1 – .25) = 7,333). The Roth IRA advantage is $6,364 when compared to a currently taxed side fund (190,956 – 143,217 – 41,395 = 6,364) and $5,060 when compared to a tax deferred side fund (190,956 – 143,217 – 42,679 = 5,060).

	Roth IRA		Traditional IRA		Side Fund		
Year	**Deposit**	**Value**	**Deposit**	**Value**	**Deposit**	**Currently Taxed**	**Tax Deferred**
1	5,500	5,775	5,500	5,775	1,375	1,427	1,444
2	5,500	11,839	5,500	11,839	1,375	2,907	2,960
3	5,500	18,206	5,500	18,206	1,375	4,442	4,551
4	5,500	24,891	5,500	24,891	1,375	6,035	6,223
5	5,500	31,911	5,500	31,911	1,375	7,688	7,978
6	5,500	39,281	5,500	39,281	1,375	9,403	9,820
7	5,500	47,020	5,500	47,202	1,375	11,182	11,755
8	5,500	55,146	5,500	55,146	1,375	13,028	13,787
9	5,500	63,678	5,500	63,678	1,375	14,943	15,920
10	5,500	72,637	5,500	72,637	1,375	16,930	18,159
11	5,500	82044	5,500	82,044	1,375	18,992	20,511
12	5,500	91,921	5,500	91,921	1,375	21,130	22,980
13	5,500	102,292	5,500	102,292	1,375	23,349	25,573
14	5,500	113,182	5,500	113,182	1,375	25,652	28,296
15	5,500	124,616	5,500	124,616	1,375	28,040	31,154
16	5,500	136,622	5,500	136,622	1,375	30,518	34,156
17	5,500	149,228	5,500	149,228	1,375	33,089	37,307
18	5,500	162,465	5,500	162,465	1,375	35,756	40,616
19	5,500	176,363	5,500	176,363	1,375	38,524	44,091
20	5,500	190,956	5,500	190,956	1,375	41,395	47,739
Less Taxes				47,739		0	5,060
Net Distribution		190,956		143,217		41,395	42,679

EDUCATIONAL TAX INCENTIVES

Contributions, Benefits, & Offsets

Incentive	Limit	Tax Nature	Covers	AGI Phaseout[1]	Note
American Opportunity Credit (§25A)	2,500	Credit against taxes (refundable in part).	First *four* years of post-secondary education.	S: ~~54,000-80,000~~ J: ~~108,000-160,000~~	ABC
Lifetime Learning Credit (§25A)	2,000	Credit against taxes.	Unlimited number of years.	S: ~~54,000-64,000~~ J: ~~109,000-129,000~~	ABC
Trade or Business Expense (§162)	None.	Below-line deduction (must itemize).	Employee expenses in maintaining or improving skills.	None.	n/a
Employer Tuition Reimbursement (§127)	5,250	Not included in income.	Covers both undergraduate and graduate programs.	None.	A
Coverdell Education Savings Account (§530)	2,000	Contributions not deductible; but earnings are tax-free.	Qualified education expenses.[2]	S: 95,000-110,000 J: 190,000-220,000	B
Student Loans (§221)	2,500	Above-line deduction for interest (need not itemize).	Student loan interest.	S: 65,000-80,000 J: 130,000-160,000	n/a
Section 529 Plans	Varies.	Contributions not deductible; but distributions are tax-free.	Tuition, fees, special-needs services, room, board, books, supplies, and equipment.	None.	C
Educational Savings Bonds (§135)	Varies.	Interest tax-free.	Qualified educational expenses.	S: 79,000-92,200 J: 115,750-145,750	n/a

A – American Opportunity and Lifetime Learning Credits are not available for the same expense excluded as an Employer Tuition Reimbursement.

B – Earnings on Coverdell Education Savings Account are not tax-free if used for same expenses as American Opportunity and Lifetime Learning Credits.

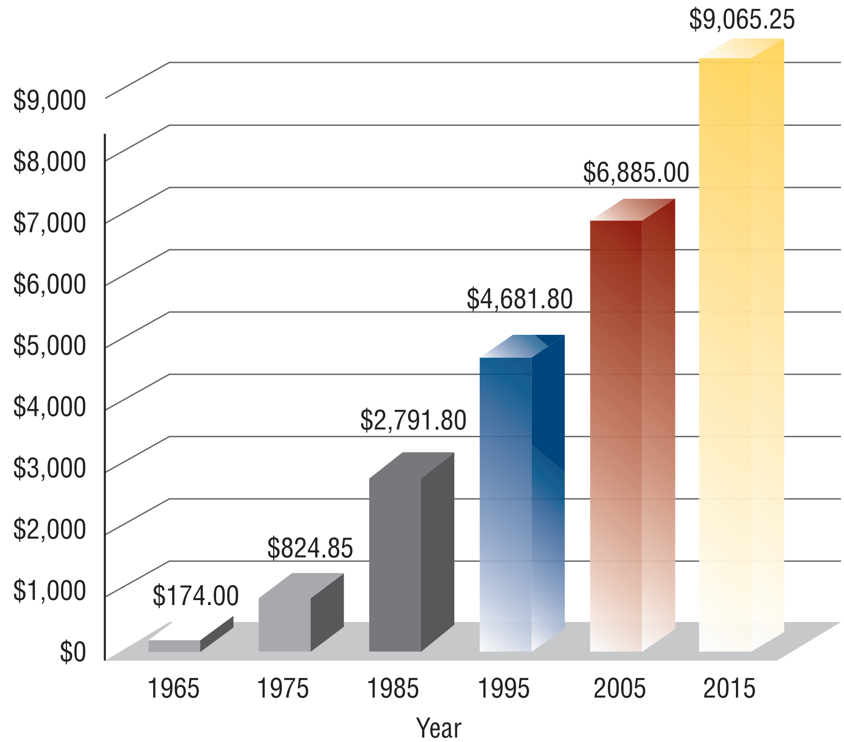
C – Section 529 qualifying expenses are reduced to the extent they are used in determining American Opportunity and Lifetime Learning Credits.

[1] S – single taxpayer; J – married filing joint return.

[2] Includes elementary and secondary education (K-12) at private, public, or religious institutions, and post secondary education at accredited public, nonprofit, and proprietary institutions (college and graduate programs).

References

HISTORICAL INCREASES OF SOCIAL SECURITY TAXES



Social Security Tax. The Social Security Tax (FICA) is paid by both the employer and the employee. For example, in 2015 an employer who pays an employee wages of $118,500 per year will pay an additional ~~$8,950.50~~ (Social Security Taxes equal to 7.65% of $~~117,000~~). The employee must also pay $~~9,027~~ (6.2% OASDI plus 1.45% hospital insurance tax). (The OASDI rate reduction of 2% that was available in 2012 was not extended by Congress.)

Federal Unemployment Tax. In addition to these Social Security Taxes, Unemployment Taxes may have to be paid. In 2015, the Federal Unemployment Tax (FUTA) is 6.0% of the first $7,000 of wages paid to each employee, or $420 (credit is given to employers for contributions to state unemployment funds).

Self-Employment Tax. An individual who is self-employed must pay a Self-Employment Tax on net earnings from self-employment when these earnings are $400 or more. The tax is equal to the combined employer-employee Social Security tax and is 12.40% OASDI tax on the first $118,500 of self-employment income in 2015, or a maximum tax of $14,694, plus 2.90% hospital insurance tax on all self-employment income in 2015. (The OASDI rate reduction of 2% that was available in 2012 was not extended by Congress.) For self-employed individuals with earnings in excess of certain filing status thresholds (e.g., $250,000 if married filing jointly and $200,000 if filing single) the Medicare portion of the self-employment tax is increased by 0.9 percent – from 2.90% to 3.80%.

Tax on Investment Income. Effective January 1, 2013, the 2010 Health Care Tax Act imposes a 3.80% Medicare tax on investment income on the lesser of (a) net investment income or (b) the excess of modified adjusted gross income in excess of $250,000 in the case of married taxpayers filing a joint return, $125,000 for married taxpayers filing a separate return, and $200,000 for all other taxpayers.

SOCIAL SECURITY PAYROLL TAXES

Taxes in Future Years Subject to Change, Generally Upward!

Year	Maximum Tax Rate	Maximum Taxable Earnings	Tax
1976	5.85	15,300	895.05
1977	5.85	16,500	965.25
1978	6.05	17,700	1,070.85
1979	6.13	22,900	1,403.77
1980	6.13	25,900	1,587.67
1981	6.65	29,700	1,975.05
1982	6.7	32,400	2,170.80
1983	6.7	35,700	2,391.90
1984	7.0	37,800	2,532.60
1985	7.05	39,600	2,791.80
1986	7.15	42,000	3,003.00
1987	7.15	43,800	3,131.70
1988	7.51	45,000	3,379.50
1989	7.51	48,000	3,604.80
1990	7.65	51,300	3,924.45
1991	7.65	53,400	4,085.10
1992	7.65	55,500	4,245.75
1993	7.65	57,600	4,406.40
1994	7.65	60,600	4,635.90
1995	7.65	61,200	4,681.80
1996	7.65	62,700	4,796.55
1997	7.65	65,400	5,003.10
1998	7.65	68,400	5,232.60
1999	7.65	72,600	5,553.90
2000	7.65	76,200	5,829.30
2001	7.65	80,400	6,150.60
2002	7.65	84,900	6,494.85
2003	7.65	87,000	6,655.50
2004	7.65	87,900	6,724.35
2005	7.65	90,000	6,885.00
2006	7.65	94,200	7,206.30
2007	7.65	97,500	7,458.75
2008	7.65	102,000	7,803.00
2009	7.65	106,800	8,170.20
2010	7.65	106,800	8,170.20
2011	5.65	106,800	6,034.20
2012	5.65	110,100	6,220.65
2013	7.65	113,700	8,823.12
2014	7.65	117,000	8,950.50
2015	7.65	118,500	~~9,027.00~~

Note: All earnings above $~~117,000~~ are subject to an additional 1.45% hospital insurance tax (see page 314).

SOCIAL SECURITY RETIREMENT BENEFITS

When To Take

Social Security retirement benefits are based upon the worker's primary insurance amount (PIA). The PIA is the monthly amount that would be paid to a worker who receives benefits at normal retirement age. The normal retirement age differs, depending upon the worker's year of birth.

Year of birth	Normal Retirement Age	Year of birth	Normal Retirement Age
Before 1938	65 years	1955	66 years, 2 months
1939	65 years, 2 months	1956	66 years, 4 months
1940	65 years, 6 months	1957	66 years, 6 months
1941	65 years, 8 months	1958	66 years, 8 months
1942	65 years, 10 months	1959	66 years, 10 months
1943-1954	66 years	1960 and after	67 years

A worker can take retirement benefits as early as age 62, but the amount received is calculated by *reducing* the PIA by 5/9 of 1 percent per month for the first 36 months, plus 5/12 of 1 percent for any additional months. For example, a worker taking payments three years prior to normal retirement age will receive only 80 percent of his PIA (i.e., $100 - (5/9 \times 36) = 80$). In addition, a worker who no longer pays social security taxes fails to *increase* his PIA.

Many authorities agree that, for the average worker, it is best to wait until normal retirement age in order to take full (unreduced) retirement benefits. Despite this, Social Security records indicate that well over 50 percent of retiring workers take early (reduced) benefits. Clearly, if life expectancy is less than average, then taking an early benefit is indicated. However, if an individual is in good health, and does not require the money to provide for retirement, the following table may assist in making the decision:

Cross-Over Point Based Upon Life Expectancy*			
Discount Rate	When Reached	Discount Rate	When Reached
0%	13 years, 3 months	6%	19 years, 9 months
2%	14 years, 8 months	8%	26 years, 1 month
4%	16 years, 8 months	10%	Never

This table compares the present values of the income streams produced by reduced (early) and unreduced (normal) retirement benefits. For example, using a discount rate of 4%, for the first 16 years and 8 months the present value of reduced retirement payments are greater than the present value of unreduced retirement payments (assuming retirement three years prior to normal retirement age, and 2.5% annual increases in retirement benefits); when the cross-over point is reached at 16 years and 8 months, the present value of the unreduced benefits will finally exceed the present value of the reduced benefits. Absent other considerations, a person who views the time value of money at 4% should consider early retirement if he expects to live *less than* 16 years and 8 months. On the other hand, if he expects to live *at least* 16 years and 8 months, he should wait until normal retirement. See also, Compound Interest & Present Value of Money, page 597.

* Assumes payments begin 36 months prior to normal retirement age, and Social Security benefit increases of 2.5% per year (the average increase during the 10-year period 2006-2015).

CONSUMER PRICE INDEX

(annual average)

Year	Yearly Increase	Cumulative Increase	Purchasing Power of the Dollar
1983	3.2	99.6	1.00
1984	4.3	103.9	.96
1985	3.6	107.6	.93
1986	1.9	109.6	.91
1987	3.6	113.6	.88
1988	4.1	118.3	.85
1989	4.8	124.0	.81
1990	5.4	130.7	.77
1991	4.2	136.2	.73
1992	3.0	140.3	.71
1993	3.0	144.5	.69
1994	2.6	148.2	.68
1995	2.8	152.4	.66
1996	3.0	156.9	.64
1997	2.3	160.5	.62
1998	1.6	163.0	.61
1999	2.2	166.6	.60
2000	3.4	172.2	.58
2001	2.8	177.1	.56
2002	1.6	179.9	.56
2003	2.3	184.0	.54
2004	2.7	188.9	.53
2005	3.4	195.3	.51
2006	3.2	201.6	.50
2007	2.8	207.3	.48
2008	3.8	215.3	.46
2009	-0.4	214.5	.47
2010	1.6	218.1	.46
2011	3.2	224.9	.44
2012	2.4	230.3	.43
2013	1.5	233.0	.43

Source: *Table 24, Historical Consumer Price Index for All Urban Consumers (CPI-U): U.S. City Average, all items*, Bureau of Labor Statistics, Washington, D.C. The Consumer Price Index is a measure of the average change in prices over time in a fixed "market basket" of goods and services purchased by urban consumers. The items include food, clothing, shelter, fuels, transportation, fares, charges for doctors' and dental services, drugs, etc. purchased for day-to-living. The reference base year is the 1982-84 period (i.e., 1982-84 = 100).

PROJECTED EARNINGS

5% Annual Increase In Earnings

Present Earnings	Yearly Earnings In 5 Years	10 Years	15 Years	20 Years	Total Earning Over Next 10 Years	20 Years
10,000	12,763	16,289	20,789	26,533	125,779	330,660
12,000	15,315	19,547	24,947	31,840	150,935	396,791
14,000	17,868	22,805	29,105	37,146	176,090	462,923
16,000	20,421	26,062	33,263	42,453	201,246	529,055
18,000	22,973	29,320	37,421	47,759	226,402	595,187
20,000	25,526	32,578	41,579	53,066	251,558	661,319
25,000	31,907	40,722	51,973	66,332	314,447	826,649
30,000	38,288	48,867	62,368	79,599	377,337	991,979
35,000	44,670	57,011	72,762	92,865	440,226	1,157,308
40,000	51,051	65,156	83,157	106,132	503,116	1,322,638
45,000	57,433	73,300	93,552	119,398	566,005	1,487,968
50,000	63,814	81,445	103,946	132,665	628,895	1,653,298
60,000	76,577	97,734	124,736	159,198	754,674	1,983,957
70,000	89,340	114,023	145,525	185,731	880,452	2,314,617
80,000	102,103	130,312	166,314	212,264	1,006,231	2,645,276
90,000	114,865	146,601	187,104	238,797	1,132,010	2,975,936
100,000	127,628	162,889	207,893	265,330	1,257,789	3,306,595

8% Annual Increase In Earnings

Present Earnings	Yearly Earnings In 5 Years	10 Years	15 Years	20 Years	Total Earnings Over Next 10 Years	20 Years
10,000	14,693	21,589	31,722	46,610	144,866	457,620
12,000	17,632	25,907	38,066	55,931	173,839	549,144
14,000	20,571	30,225	44,410	65,253	202,812	640,667
16,000	23,509	34,543	50,755	74,575	231,785	732,191
18,000	26,448	38,861	57,099	83,897	260,758	823,715
20,000	29,387	43,178	63,443	93,219	289,731	915,239
25,000	36,733	53,973	79,304	116,524	362,164	1,144,049
30,000	44,080	64,768	95,165	139,829	434,597	1,372,859
35,000	51,426	75,562	111,026	163,133	507,030	1,601,669
40,000	58,773	86,357	126,887	186,438	579,462	1,830,479
45,000	66,120	97,152	142,748	209,743	651,895	2,059,288
50,000	73,466	107,946	158,608	233,048	724,328	2,288,098
60,000	88,160	129,535	190,330	279,657	869,194	2,745,718
70,000	102,853	151,125	222,052	326,267	1,014,059	3,203,337
80,000	117,546	172,714	253,774	372,877	1,158,925	3,660,957
90,000	132,240	194,303	285,495	419,486	1,303,791	4,118,577
100,000	146,933	215,892	317,217	466,096	1,448,656	4,576,196

Explanation of Tables. These tables assume that earnings increase at an annual rate of either 5 or 8 percent. For example, at annual increases of 5 percent an individual earning $50,000 today would be earning $81,445 in 10 Years, and total earnings over 10 Years would be $628,895. Projected earnings are also considered in the discussion of Human Life Value on page 14.

PENALTY OF WAITING

What It Takes To Save $100,000 By Age 65
Assuming 6% Interest

Current Age	Monthly Deposit	Total Deposits	Penalty of Waiting 1 Year	Penalty of Waiting 5 Years
21	40.42	21,342	877	4,707
22	43.06	22,219	905	4,867
23	45.88	23,124	945	5,043
24	48.92	24,069	973	5,208
25	52.17	25,042	1,007	5,387
26	55.66	26,049	1,037	5,567
27	59.40	27,086	1,081	5,758
28	63.44	28,167	1,110	5,944
29	67.77	29,277	1,152	6,137
30	72.45	30,429	1,187	6,334
31	77.49	31,616	1,228	6,535
32	82.94	32,844	1,267	6,740
33	88.83	34,111	1,303	6,950
34	95.20	35,414	1,349	7,168
35	102.12	36,763	1,388	7,382
36	109.63	38,151	1,433	7,604
37	117.81	39,584	1,477	7,830
38	126.73	41,061	1,521	8,059
39	136.48	42,582	1,563	8,289
40	147.15	44,145	1,610	8,528
41	158.87	45,755	1,659	8,769
42	171.79	47,414	1,706	9,010
43	186.06	49,120	1,751	9,257
44	201.87	50,871	1,802	9,507
45	219.47	52,673	1,851	9,760
46	239.14	54,524	1,900	10,017
47	261.22	56,424	1,953	10,277
48	286.16	58,377	2,001	10,536
49	314.47	60,378	2,055	10,800
50	346.85	62,433	2,108	11,067
51	384.17	64,541	2,160	11,338
52	427.57	66,701	2,212	11,610
53	478.56	68,913	2,265	11,878
54	539.23	71,178	2,322	12,160
55	612.50	73,500	2,379	12,433
56	702.58	75,879	2,432	12,697
57	815.74	78,311	2,480	12,971
58	961.80	80,791	2,547	13,268
59	1,157.47	83,338	2,595	13,542
60	1,432.21	85,933	2,643	14,067

Explanation of Table: This table shows the amount of money which must be deposited at the beginning of each month in order to accumulate $100,000 by age 65. Interest is credited at a 6 percent net annual rate and is compounded monthly (i.e., it is credited at the end of each month assuming a 6 percent annual after tax or untaxed growth). The Penalty Of Waiting 1 Year is calculated by subtracting total deposits at the current age from total deposits one year later (e.g., at age 45 the penalty of waiting one year is $54,524 - $52,673, or $1,851). The Penalty Of Waiting 5 Years is calculated by subtracting total deposits at the current age from total deposits five years later (e.g., at age 45 the penalty of waiting five years is $62,433 - $52,673, or $9,760).

EARLY SAVER vs. LATE SAVER

The Advantage Of Saving Early For Retirement
Assuming 8% Interest

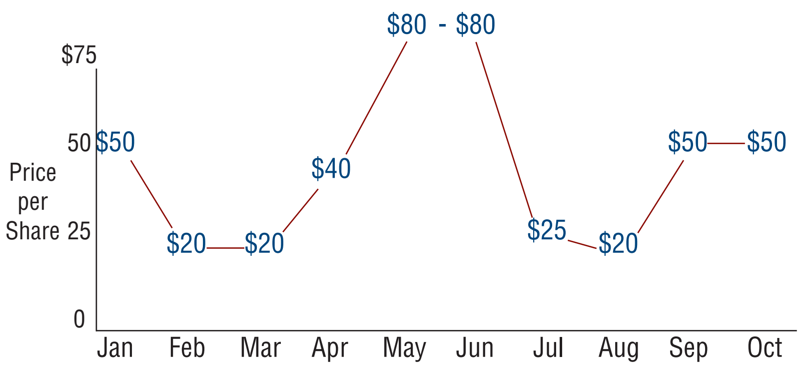
	Age	Early Saver	Late Saver	Age	Early Saver	Late Saver	Age	Early Saver	Late Saver
	30	$2,000	0						
	31	2,000	0						
	32	2,000	0						
	33	2,000	0						
	34	2,000	0						
	35	2,000	0						
	36	2,000	0						
	37	2,000	0						
	38	2,000	0						
	39	2,000	0						
	40	0	$2,000	40	$2,000	0			
	41	0	2,000	41	2,000	0			
	42	0	2,000	42	2,000	0			
	43	0	2,000	43	2,000	0			
	44	0	2,000	44	2,000	0			
	45	0	2,000	45	2,000	0			
	46	0	2,000	46	2,000	0			
	47	0	2,000	47	2,000	0			
	48	0	2,000	48	0	$2,000			
	49	0	2,000	49	0	2,000			
	50	0	2,000	50	0	2,000	50	$2,000	0
	51	0	2,000	51	0	2,000	51	2,000	0
	52	0	2,000	52	0	2,000	52	2,000	0
	53	0	2,000	53	0	2,000	53	2,000	0
	54	0	2,000	54	0	2,000	54	2,000	0
	55	0	2,000	55	0	2,000	55	2,000	0
	56	0	2,000	56	0	2,000	56	0	$2,000
	57	0	2,000	57	0	2,000	57	0	2,000
	58	0	2,000	58	0	2,000	58	0	2,000
	59	0	2,000	59	0	2,000	59	0	2,000
	60	0	2,000	60	0	2,000	60	0	2,000
	61	0	2,000	61	0	2,000	61	0	2,000
	62	0	2,000	62	0	2,000	62	0	2,000
	63	0	2,000	63	0	2,000	63	0	2,000
	64	0	2,000	64	0	2,000	64	0	2,000
Total Invested		$20,000	$50,000		$16,000	$34,000		$12,000	$18,00
Amount at Age 65		$214,296	$157,909		$85,008	$72,900		$31,676	$26,973

Explanation of Table: This table demonstrates the advantage of beginning to save early for retirement. For example, a 40-year-old Early Saver who saves $2,000 per year for eight years, and earns 8 percent per year on his savings, will accumulate $85,008 by age 65. In comparison, a 48-year-old Late Saver who saves $2,000 per year until age 65, will accumulate only $72,900. Whereas the Late Saver has invested $18,000 more than the Early Saver, he has accumulated $12,108 less than the Early Saver ($34,000 - $16,000 = $18,000; $85,008 - $72,900 = $12,108). If savings had been placed in a tax deferred investment, then the Amount At Age 65 will likely be reduced by income taxes.

DOLLAR COST AVERAGING

Investing A Fixed Sum At Regular Intervals
means that
More Shares Are Bought At Low Prices Than High Prices
and
Average Cost Is Lower Than Average Share Price

Market Price Fluctuations



<u>INVESTING FIXED SUM - DOLLAR COST AVERAGING</u>

											Totals
Cost	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	$1,000
Shares	2	5	5	2.5	1.25	1.25	4	5	2	2	30

Average Cost Per Share $33.33

↑ end up with same number of shares ↓

<u>BUYING FIXED NUMBER OF SHARES</u>

Shares	3	3	3	3	3	3	3	3	3	3	30
Cost	$150	$60	$60	$120	$240	$240	$75	$60	$150	$150	$1,305

Average Cost Per Share $43.50

Note. Dollar cost averaging neither guarantees a profit nor protects against a loss.

HOW MONEY GROWS

How Much Monthly Savings Will Accumulate To

	Accumulated at 5%		
Save Per Month	5 Years	10 Years	20 Years
50	3,414	7,796	20,637
100	6,829	15,593	41,275
250	17,072	38,982	103,187
500	34,145	77,965	206,373
1,000	68,289	155,929	412,746

	Accumulated at 8%		
Save Per Month	5 Years	10 Years	20 Years
50	3,698	9,208	29,647
100	7,397	18,417	59,295
250	18,492	46,041	148,237
500	36,983	92,083	296,474
1,000	73,967	184,166	592,947

	Accumulated at 10%		
Save Per Month	5 Years	10 Years	20 Years
50	3,904	10,328	38,285
100	7,808	20,655	76,570
250	19,521	51,638	191,424
500	39,041	103,276	382,848
1,000	78,082	206,552	765,697

Explanation of Table. All accumulations assume monthly contributions are made on the first day of the month with interest compounded monthly. All results are rounded to the nearest whole dollar. Accumulated amounts assume the funds are invested at a rate of 5, 8, or 10 percent before taxes (i.e., during the accumulation phase appreciation is not subject to current income taxation). For example, if an individual invested $100 per month and earned 8 percent compounded monthly, at the end of 10 years the funds would accumulate to $18,417. Referring to the table How Money Goes on page 323, if this $18,417 were invested at 5 percent per year compounded monthly, it would provide $195 per month for 10 years or $121 per month for 20 years. Withdrawing interest only, without invading principal, would provide $77 per month. All withdrawal amounts are before taxes.

HOW MONEY GOES

How Much Can Be Withdrawn Monthly From A Given Accumulation

Amount	At 5% Interest			At 8% Interest		
Accumulated	10 years	20 Years	Forever	10 Years	20 Years	Forever
3,414	36	22	14	41	28	23
3,698	39	24	15	45	31	25
3,904	41	26	16	47	32	26
6,829	72	45	28	82	57	46
7,397	78	49	31	89	61	49
7,796	82	51	32	94	65	52
7,808	82	51	33	94	65	52
9,208	97	61	38	111	77	61
10,328	109	68	43	124	86	69
15,593	165	102	65	188	130	104
17,072	180	112	71	206	142	114
18,417	195	121	77	222	153	123
18,492	195	122	77	223	154	123
19,521	206	128	81	235	162	130
20,637	218	136	86	249	171	138
20,655	218	136	86	249	172	138
29,647	313	195	124	357	246	198
34,145	361	224	142	412	284	228
36,983	391	243	154	446	307	247
38,285	404	252	160	461	318	255
38,982	412	256	162	470	324	260
39,041	412	257	163	471	324	260
41,275	436	271	172	497	343	275
46,041	486	303	192	555	383	307
51,638	545	339	215	622	429	344
59,295	626	390	247	715	493	395
68,289	721	449	285	823	567	455
73,967	781	486	308	891	615	493
76,570	809	503	319	923	636	510
77,965	824	512	325	940	648	520
78,082	825	513	325	941	649	521
92,083	973	605	384	1,110	765	614
103,187	1,090	678	430	1,244	857	688
103,276	1,091	679	430	1,245	858	689
148,237	1,566	974	618	1,787	1,232	988
155,929	1,647	1,025	650	1,879	1,296	1,040
184,166	1,945	1,210	767	2,220	1,530	1,228
191,424	2,022	1,258	798	2,307	1,591	1,276
206,373	2,180	1,356	860	2,487	1,715	1,376
206,552	2,182	1,357	861	2,489	1,716	1,377
296,474	3,132	1,948	1,235	3,573	2,463	1,976
382,848	4,044	2,516	1,595	4,614	3,181	2,552
412,746	4,360	2,713	1,720	4,975	3,430	2,752
592,947	6,263	3,897	2,471	7,146	4,927	3,953
765,697	8,088	5,032	3,190	9,228	6,362	5,105

Explanation of Table. Withdrawals are assumed to be made at the beginning of each month with interest compounded monthly on the remaining funds invested at either 5 or 8 percent interest. Results are rounded to the nearest whole dollar. All calculations and amounts are before taxes. It is intended that this table be used with the table How Money Grows on page 322 (i.e., first obtain the amount accumulated from How Money Grows, then enter this table). See explanation at the bottom of page 322.

MEDICAL EXPENSE PROGRAMS

A variety of medical expense programs are available, each with unique features, benefits and tax implications. This chart provides an overview of their essential characteristics.

Health Reimbursement Arrangement HRA

This is an "arrangement"; it is not an account. Allows tax-free reimbursement to employees for qualified health care expenses, including the employee's purchase of health insurance (e.g., long-term care premiums). Plans are either insured or self-insured. Governed by IRC Section 105, it is funded and owned by the employer.

Formal guidance from the IRS allows a carryover of unused amounts to later years. Not available to the self-employed.

See Health Reimbursements Arrangements chart, page 253.

Flexible Spending Account FSA

A health FSA allows employees to make pre-tax contributions to an account to pay for health care expenses or their share of health insurance premiums (dependent care FSAs allow payment of qualifying child care expenses). Reimbursement for over-the-counter drugs is not allowed. Governed by IRC Section 125.

Can only be set up by employers (not available to the self-employed). Typically included under cafeteria plans, but may stand-alone. Any unused balance is forfeited at the end of the year (the infamous use-it-or-lose-it provision).

See Cafeteria Plans, page 339.

Health Savings Account HSA

The HSA is similar to the now outdated Medical Savings Account (MSA), but without the restrictions or limits on participation. Any "eligible individual" with a "high deductible health plan" can contribute. Generally allows reimbursement for "qualified medical expenses," to include long-term care insurance premiums but not over-the-counter drugs. May be included under cafeteria plans. Governed by new IRC Section 223. Contributions may be invested like IRAs (e.g., in stocks and bonds). Undistributed amounts may be carried forward.

See Health Savings Accounts chart, page 257.

Consumer-Directed Health Plan

Also referred to as a "Consumer-Driven" Health Plan, this is a catch-all term that can include Health Reimbursement Arrangement (HRAs), Flexible Spending Accounts (FSAs), and Health Savings Accounts (HSAs).

DISABILITY STATISTICS

Odds This Year For Different Risks Covered By Insurance

1 out of 5 that your auto will be damaged in an accident (National Safety Council).

1 out of 21 that you will have a disabling accident (National Safety Council).

1 out of 96 that you will have a fire (National Safety Council).

1 out of 114 that you will die (World Almanac).

Income Lost Through Disability Is

2 times as great as *auto* accident losses.

3 times as great as *fire* losses.

Risk of Disability Is Substantially Greater Than Risk Of Death (Male)

At age 30, long-term disability is 4.0 times more likely than death.

At age 40, long-term disability is 2.9 times more likely than death.

At age 50, long-term disability is 2.3 times more likely than death.

Risk Of Disability Within Groups Of People

The following chart indicates the odds of at least one long-term (90-day) disability occurring before age 65 to any one person out of one, two, or three persons.

	Chances out of 1,000 of Disability Occurring Prior to Age 65		
Age of Each Person	To Any One Person	To Any One Person out of Any Two People	To Any One Person out of Any Three People
30	467	716	849
35	451	699	835
40	430	675	815
45	401	641	785
50	360	590	738

From the chart we can conclude, for example, that 43 percent of all people age 40 will have a long-term disability prior to age 65.

Long-Term Disabilities

If a long-term (90-day) disability has lasted two years, it will probably continue longer – even for life.

Age When Disabled For 90 Days	Percentage Of People Still Disabled At End Of 2 Years And 90 Days	Percentage Of People Still Disabled At End Of 5 Years And 90 Days
25	63.5%	44.2%
35	69.7	52.6
45	73.6	58.0
55	77.6	59.6

Source: Figures based upon Commissioners Disability Table and Commissioners 1980 Standard Ordinary Mortality Table.

DISABILITY INCOME - TAX CONSIDERATIONS

	PREMIUM PAYMENTS Income Tax Effects As To		PROCEEDS Income Tax Effects As To	
	Employer	Insured	Employer	Insured
NONCONTRIBUTORY PLANS				
Employer pays premium	deductible IRC §162(a)		no effect	
Insured owns policy receives benefit		not taxable IRC §106(a)		taxable
Employer pays premium owns policy receives benefit	not deductible IRC §265		proceeds subject to corporate AMT (see pages 363-365) but deductible when paid to employee	
Insured receives benefit		not taxable IRC §106(a)		taxable when received from employer
CONTRIBUTORY PLAN				
Employer pays part of each premium	deductible IRC §162(a)		no effect	
Insured owns policy pays balance of premium receives benefit		not taxable on employer's contribution		taxable on amount attributable to employer contribution but not taxable on amount attributable to own contribution
NO PLAN NECESSARY				
Employer pays bonus to insured	deductible IRC §162(a)		no effect	
Insured pays premium owns policy receives benefit		taxable as salary IRC §61		not taxable IRC§104(a)(3)

Note: Insured is assumed to be an employee (not partner or sole proprietor).