

# 2017

## Retirement Planning Guide

IRA | Roth | SEP | SIMPLE | DB | 401(a) | 401(k) | 403(b) | Life Insurance



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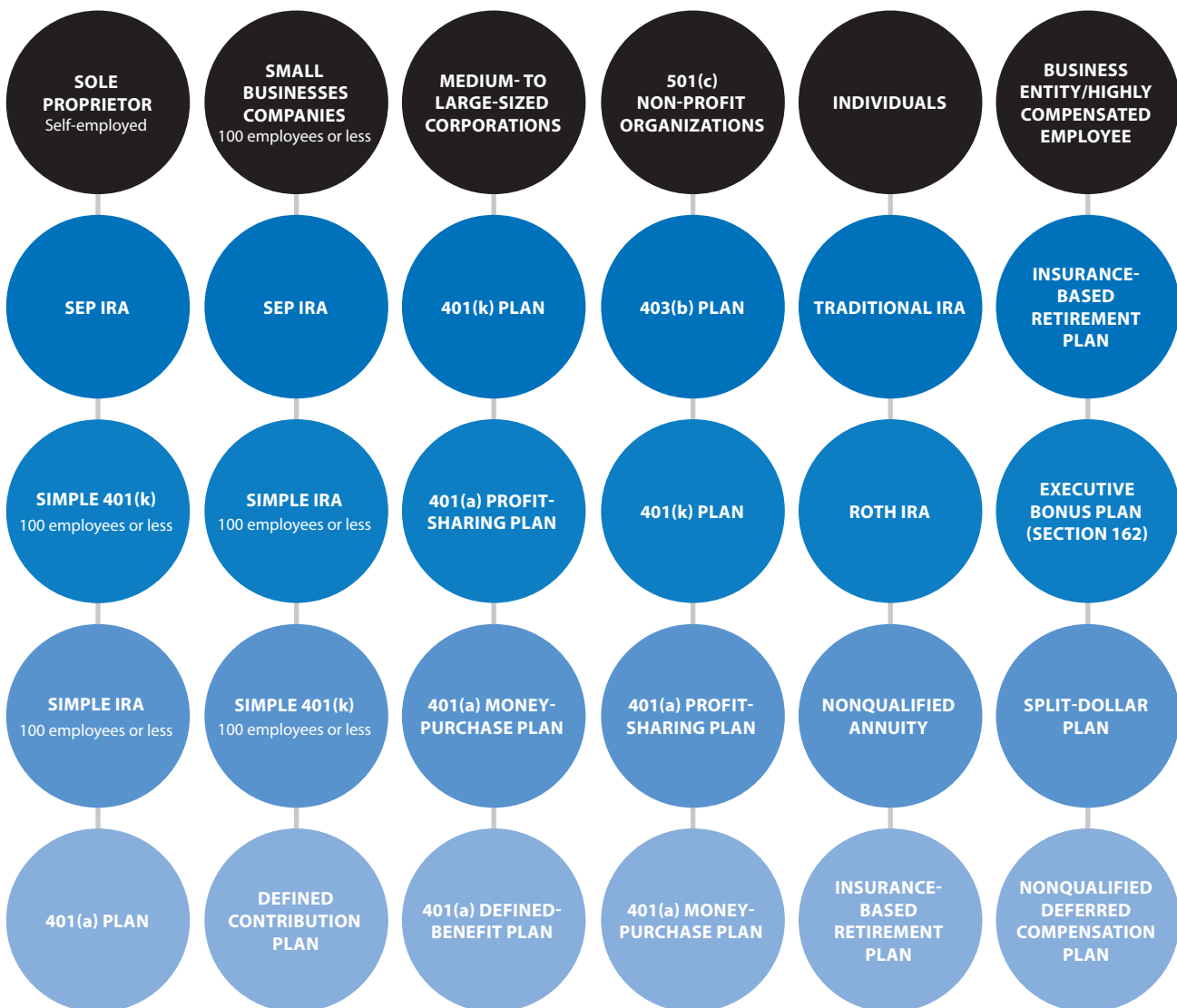
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## Plan Positioning Flow Chart



# Traditional IRA

## **IRA – Individual Retirement Account**

*A tax-favored savings plan that encourages accumulation of savings for retirement*

### Contribution Limits

- Annual contribution limit for individuals is the lesser of \$5,500 or 100% of compensation; the \$5,500 limit includes contributions for both a traditional IRA and Roth IRA combined.
- Married couple's maximum annual contribution is the lesser of \$11,000 or 100% of compensation; each spouse must maintain his or her own separate IRA, and the \$5,500 limit applies to each spouse separately.
- Catch-up provision: Workers age 50 (by the end of the calendar year) or older are permitted to make an additional \$1,000 contribution, which makes the annual contribution limit \$6,500 for workers who attain age 50 or older on or before Dec. 31, 2017.

### IRA Eligibility and Deductibility

- Any U.S. taxpayer under age 70½ who earns compensation can make a contribution to a traditional IRA.
- If neither the taxpayer nor the taxpayer's spouse is an active participant in an employer-sponsored retirement plan, their traditional IRA contributions are deductible.
- If an individual is not an active participant in a retirement plan but the individual's spouse is a plan participant, the non-active participant's IRA contribution is deductible if the couple's adjusted gross income is below a certain limit (i.e., \$186,000 or less for full deduction; more than \$186,000 but less than \$196,000 for partial deduction, indexed for 2017).
- If an individual is an active participant in a retirement plan their IRA contributions are deductible, provided the taxpayer's adjusted gross income (AGI) falls below a certain limit. (See chart on the next page.)

# Traditional IRA *(continued)*

## 2017 Indexed AGI Limits for Deductible IRA Contributions

Filing Status	Full IRA Deduction	Reduced IRA Deduction	No IRA Deduction
<b>Married, filing separately</b>	None	Less than \$10,000	\$10,000 or more
<b>Individual</b>	\$62,000 or less	More than \$62,000 to \$72,000	\$72,000 or more
<b>Married, filing jointly</b>	\$99,000 or less	More than \$99,000 to \$119,000	\$119,000 or more

## Distributions from Traditional IRAs

- Owners may take a withdrawal from their IRA at any time; however, the withdrawal will be subject to a 10% penalty tax, in addition to ordinary income tax, unless the distribution qualifies under one of these exceptions:
  - Owner is age 59½ or older
  - Substantially equal periodic payments over IRA owner's life or life expectancy
  - Death or disability of IRA owner
  - Medical expenses in excess of 10% of adjusted gross income
  - Qualified higher education expenses (i.e., tuition, fees, books, supplies, etc.)
  - First home purchase (\$10,000 lifetime limit)
- Required minimum distributions (as defined by the IRS) must begin no later than when IRA owner attains age 70½.

## Target Market

- Individuals who are not currently participating in or contributing to an employer-sponsored retirement plan.
- Individuals interested in a rollover vehicle for retirement plans, such as a 401(k), 457(b), 403(b), defined benefit (DB) pension plan, SEP IRA or SIMPLE.

**Roth IRA** – *A type of nondeductible IRA with income-tax-free distributions*

## Differences Between Roth IRAs and Traditional IRAs

- Roth IRA contributions are made on an after-tax basis. Contributions to Roth IRAs are not deductible. Contributions to traditional IRAs may be tax deductible, depending on whether the owner participates in a retirement plan and the amount of their Adjusted Gross Income (AGI).
- Roth IRA contributions and earnings may qualify for tax-free distribution (i.e., a qualified distribution); traditional IRA contributions and earnings do not qualify for tax-free distribution.
- Nonqualified distributions from Roth IRAs are distributed “investment in the contract,” or basis, first.
- Lifetime required minimum distribution rules do not apply to Roth IRA owners but do apply to traditional IRAs.

## 2017 Contribution Limits for Roth IRAs and Traditional IRAs

- Annual contribution limit for individuals is the lesser of \$5,500 or 100% of compensation; the \$5,500 limit applies to combined contributions to both a traditional IRA and Roth IRA. An individual of any age who earns compensation may establish or contribute to a Roth IRA in the year compensation is earned.

### **Caveat:**

- Full Roth IRA contribution is permitted for single taxpayers with modified adjusted gross income (MAGI) up to \$118,000.
- Roth IRA contributions are phased out for single taxpayers with MAGI between \$118,000 and \$133,000.
- A married couple’s maximum annual individual traditional IRA contribution is the lesser of \$11,000 or 100% of compensation; each spouse must maintain his or her own separate traditional and/or Roth IRA. The \$5,500 limit applies separately to each spouse.

### **Caveat:**

- Full Roth IRA contribution is permitted for married joint filers with MAGI up to \$186,000.
- Roth IRA contributions are phased out for married joint filers with MAGI between \$186,000 and \$196,000.
- Roth IRA contributions are phased out between \$0 and \$10,000 MAGI for a married taxpayer who files separately.
- Roth IRA contributions are phased out for single, head of household filers between \$118,000 and \$133,000.
- Catch-up provision: Workers age 50 (by the end of the 2017 calendar year) or older are permitted to make an additional \$1,000 contribution for 2017, for a total 2017 IRA contribution of \$6,500.

# Roth IRA *(continued)*

## Two Requirements for Roth IRA Earnings to be Distributed Tax Free

- Distribution must be made after a five-year holding period has been satisfied.
- Distributions must be made under one of four conditions:
  - Owner has attained age 59½
  - Distribution is paid to a beneficiary at death of owner and the five-year holding period has been satisfied
  - Owner is disabled
  - Withdrawal is made to pay qualified first-time homebuyer expenses (\$10,000 lifetime limit)

## Penalty-Free Withdrawals

- Owner can withdraw money prior to age 59½ from a Roth IRA and avoid the 10% excise (penalty) tax on the taxable portion of the distribution (if any), for any of the following reasons:
  - Roth IRA funded with contributory amounts and the five-year holding period has been satisfied
  - Substantially equal periodic payments over life or life expectancy
  - Medical expenses in excess of 10% of adjusted gross income
  - New home purchase (\$10,000 lifetime limit)
  - Qualified higher education expenses (i.e., tuition, fees, books, supplies)
  - Death
  - Disability

## Conversions from Traditional IRA to Roth IRA

Money can be converted from a traditional IRA to a Roth IRA regardless of the owner's age, amount of annual income or tax-filing status. The amount converted is taxed as income to the owner in the year of the Roth conversion.

**Roth Recharacterization Note:** Recharacterization allows an owner to reverse a Roth IRA conversion. If completed by the owner's tax return due date (including extensions), a Roth conversion can be treated as a contribution to a traditional IRA in the year of the Roth IRA conversion.

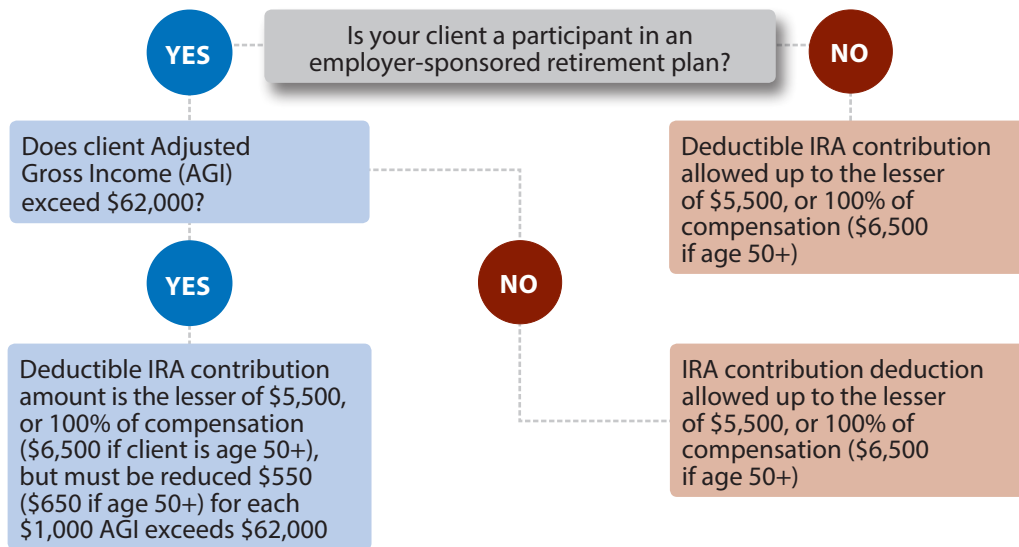
## Target Market

A Roth IRA is most tax efficient when the owner will be in a higher tax bracket at retirement than at the time the Roth IRA contribution or conversion is made:

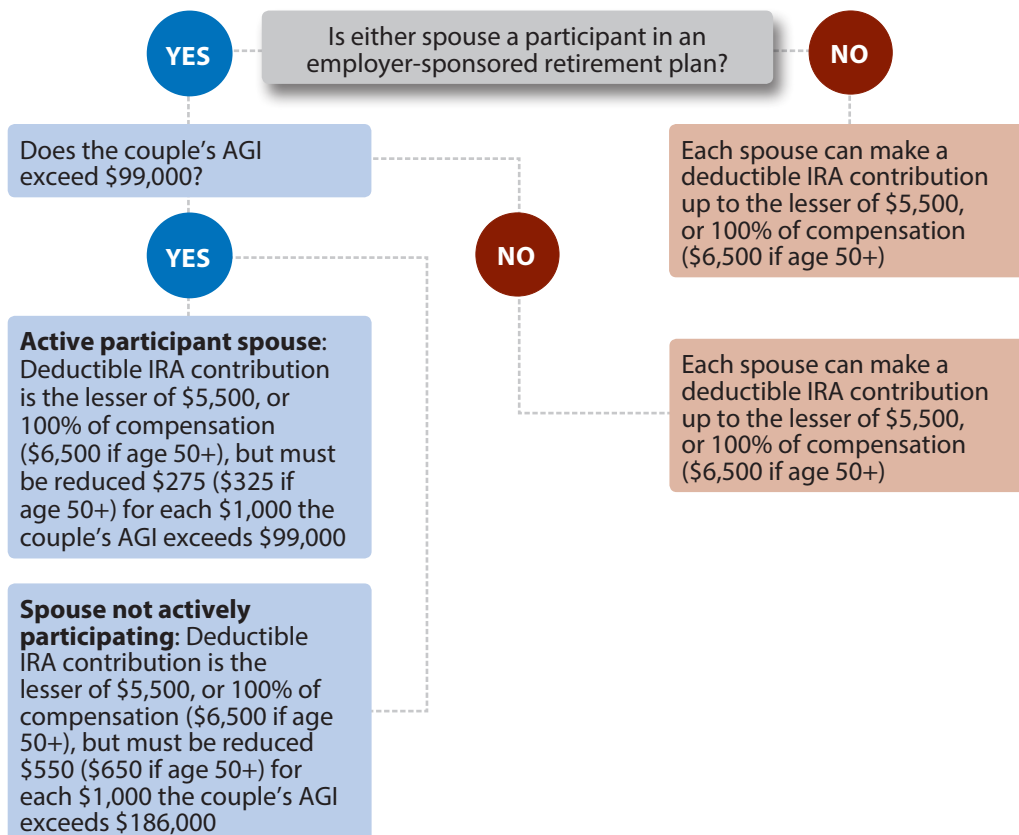
- A Roth IRA provides tax-free income, giving the owner greater flexibility in liquidating taxable assets at retirement.
- There is no requirement to take distributions during a Roth IRA owner's lifetime.
- A Roth IRA may be an appropriate choice if an individual expects to defer distributions past the date they attain age 70½, or does not plan to take Roth IRA distributions during their lifetime.

# 2017 Traditional IRA Contributions

## Single Taxpayer Client

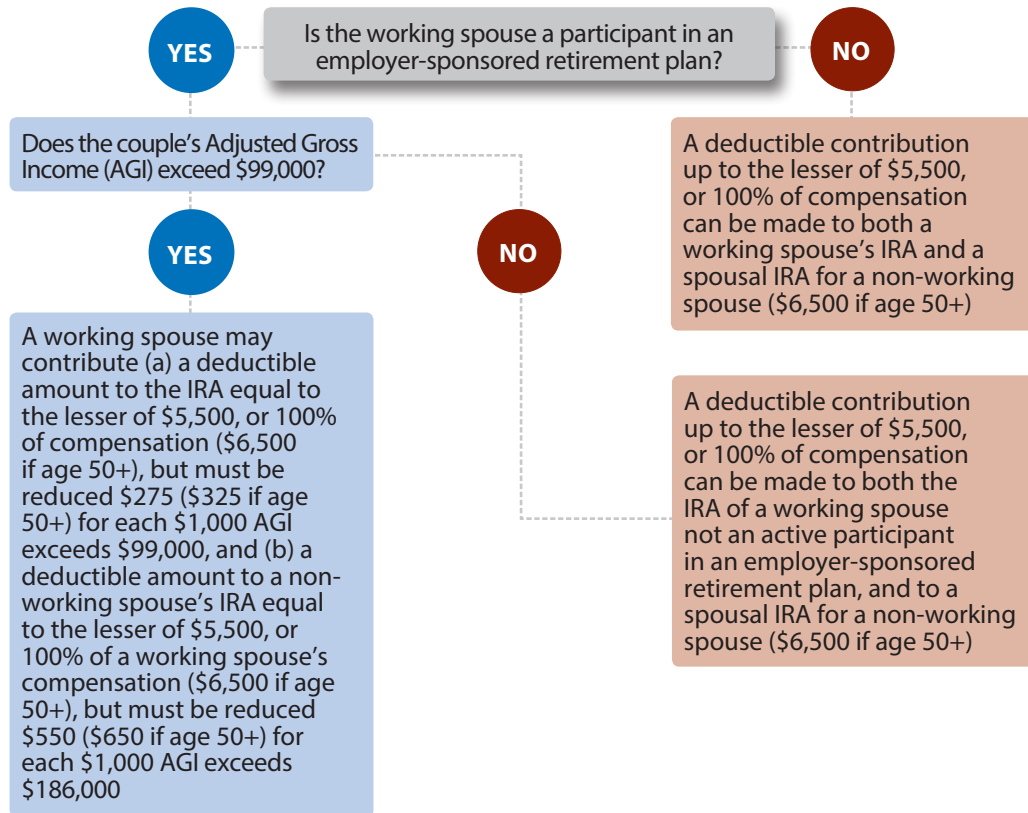


## Married Couple Filing Jointly — Both Employed



# 2017 Traditional IRA Contributions *(continued)*

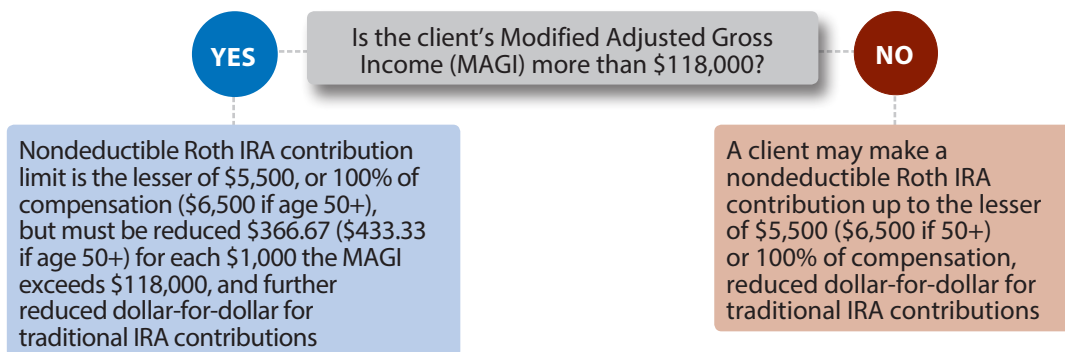
## Married Couple Filing Jointly — Only One Spouse Employed



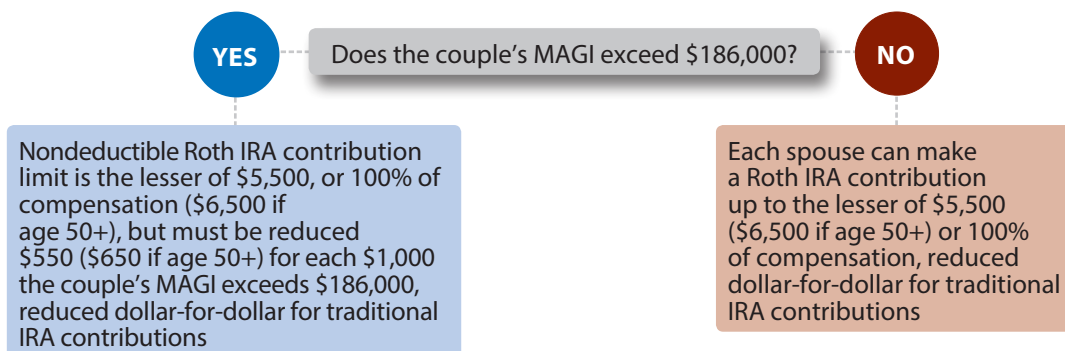


# 2017 Roth IRA Contributions

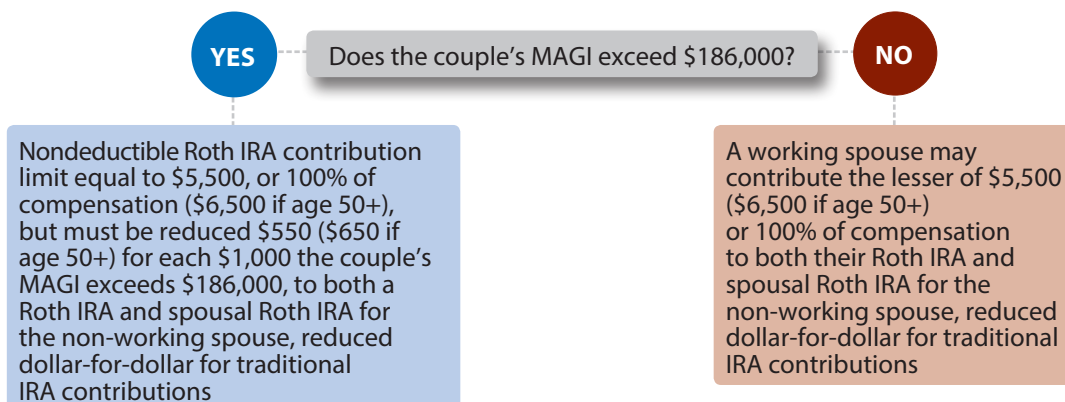
## Single Taxpayer Client



## Married Couple Filing Jointly — Both Employed



## Married Couple Filing Jointly — Only One Employed



## **SEP – Simplified Employee Pension**

*Small employer retirement plan funding an IRA with discretionary contributions*

### Employer Contribution Limits

- The SEP IRA employer contribution limit is the lesser of 25% of employee's salary (\$270,000 salary cap as indexed for 2017) or \$54,000 (this amount may be less for an employee/owner).
- The employer must contribute an equal percentage for the benefit of all eligible employees with immediate vesting of contributions. For example, if a business owner contributes 8% to their own SEP IRA, the employer must contribute 8% for all eligible employees if using IRS Form 5305.
- Employer contributions only; employee salary deferrals are not permitted except for SAR-SEP plans established prior to Jan. 1, 1997. SIMPLE IRAs permit employee salary deferrals (see next page).
- Employer contribution amounts are typically discretionary and set by the employer on a year-to-year basis.

### Employer Eligibility Requirement

- 50% of eligible employees must participate in a SEP IRA plan.

### Employee Eligibility Requirement

- Participant must have been employed by the company during at least three of the last five preceding years.
- Employee must typically be age 21 or older (however, employer can set plan eligibility age at 18) and have earned at least \$600 in compensation (as indexed for 2017).

### Key Points

- Loans from SEP IRAs are not permitted.
- SEP IRA distributions are taxed as ordinary income, as are distributions from a traditional IRA.

### Target Market

- Small employers, sole proprietors or small nonprofit organizations with a limited benefit budget looking to establish a retirement plan that is easy to administer.
- Factors favoring a SEP IRA include no filing requirements, limited fiduciary liability and less expensive administration than a 401(k), profit-sharing or defined benefit retirement plan.

# SIMPLE IRA

## **SIMPLE – Savings Incentive Match Plan for Employees**

*Small employer retirement plan funding an IRA with mandatory contributions*

### Contribution Limits

- Employer contribution limit (employer must select one of the two options below):
  - 100% match provided on the first 3% of participating employee's salary deferral.  
**Examples: If an employee defers 5% of salary into a SIMPLE IRA, the employer must contribute 3% to the employee's account. If employee defers 1% of salary, employer must contribute 1%.**
    - If employer elects this option, the maximum employer contribution is \$8,100 (\$270,000 cap x 3% in 2017).
  - 2% non-elective contribution provided for all eligible employees (regardless of participation).
    - If employer elects this option, the maximum employer contribution is \$5,400 (\$270,000 cap x 2% in 2017).
- Employee deferral limit: \$12,500 per plan year (indexed for 2017); up to 100% of compensation.
  - Employees age 50 (by the end of the calendar year) or older are permitted an additional \$3,000 catch-up contribution for 2017, if the plan permits, for a total elective deferral of \$15,500.

### Plan Eligibility Requirements

- Any type of business with 100 or fewer employees may establish a SIMPLE IRA; however, no other qualified plan, 403(b), SEP IRA or 457 plan can be maintained.
- Employer must notify participants of 60-day election period prior to the calendar year-end to elect salary deferral or modify a prior election, making the adoption deadline Oct. 1.
- Employer must provide employee with a Summary Plan Description and account statements within 30 days of the end of a calendar year. Contributions must be made between Jan. 1 and Dec. 31.
- Employer must include any employee who earned \$5,000 in any two previous years and is expected to earn \$5,000 during current year (exception: employees subject to collective bargaining).

# SIMPLE IRA *(continued)*

## Key Points

- SIMPLE IRAs replaced SAR-SEP IRA plans on Jan. 1, 1997.
- Withdrawals can't be restricted; however, withdrawals within the first two years of the employee's initial contribution are subject to a higher early withdrawal penalty tax in addition to income tax.
- All contributions (employer and employee) are 100% vested immediately.
- Participant loans are not permitted.
- No discrimination testing, annual reporting or administration fees.
- No discrimination testing means highly compensated employees can defer up to \$12,500 annually, regardless of the amount deferred by lower-compensated employees.

## Penalty Tax

- Distributions before age 59½ will be subject to a 10% early withdrawal penalty (25% if within the first two years) unless such distribution qualifies for one of the following exceptions:
  - Death
  - Disability
  - Substantially equal periodic payments over life or life expectancy of SIMPLE IRA owner
  - Medical expenses in excess of 10% of adjusted gross income
  - Qualified higher education expenses (i.e., tuition, fees, books, supplies, etc.)
  - First home purchase (\$10,000 lifetime limit)

## Target Market

- Small nonprofit organizations and small businesses with limited benefits budgets interested in a retirement plan that is inexpensive and easy to administer may find a SIMPLE IRA a good fit.
- Employers with 401(k) plans in force may not care to switch to a SIMPLE IRA plan because 401(k) plans are generally more flexible.

# SIMPLE 401(k)

## **SIMPLE 401(k) – Savings Incentive Match Plan for Employees**

*Small employer retirement plan using a simplified 401(k) as the funding vehicle*

### Contribution Limits

- Employer contribution requirement (employer must select one of the two options below):
  - 100% match provided on the first 3% of participating employee's salary deferral.  
**Examples: If an employee defers 5% of salary into a SIMPLE 401(k), the employer must contribute 3% to employee's account. If employee defers 1% of salary, employer must contribute 1%.**
    - If employer elects this option, the maximum employer contribution is \$8,100 (\$270,000 cap x 3% in 2017).
  - 2% non-elective contribution provided for all eligible employees (regardless of participation).
    - If employer elects this option, the maximum employer contribution is \$5,400 (\$270,000 cap x 2% in 2017).
- Employee deferral limit: \$12,500 per plan year (indexed for 2017); up to 100% of compensation.
  - Employees age 50 (by the end of the calendar year) or older can make an additional \$3,000 catch-up contribution for 2017, for a total contribution limit of \$15,500.

### Plan Eligibility Requirements

- Any nongovernmental business with 100 or fewer employees may establish a SIMPLE 401(k); however, no other qualified retirement plan, 403(b) plan or SEP IRA can be maintained.
- Employer must notify participants of 60-day election period prior to the calendar year-end to elect salary deferral or modify a prior election, making the plan adoption deadline Oct. 1.
- Employee deferrals generally cannot be distributed before age 59½, death, disability, termination from employment or hardship and are subject to income tax and a possible 10% penalty tax on premature distributions.
- Employees may contribute to a SIMPLE 401(k) if they have annual earnings of at least \$5,000 or have 1,000 service hours in a prior year and are at least 21 years of age. Employer may exclude nonresident aliens and certain employees subject to collective bargaining.
- A SIMPLE 401(k) plan can be converted to a traditional 401(k), and vice versa.
- The plan must be maintained on a calendar-year basis (i.e., contributions are made and employee earnings relate to a period from Jan. 1 to Dec. 31).
- Employees may contribute to a SIMPLE 401(k).

# SIMPLE 401(k) *(continued)*

## Key Points

- All contributions (employer and employee) are immediately 100% vested.
- Participant loans are permitted (if allowed by the plan document).
- No discrimination testing or top-heavy<sup>1</sup> testing is required.
- Employers with SIMPLE 401(k) plans are subject to administrative expenses for plan document filing and amendments, Form 5500 Schedule A IRS filing and IRC Sec. 415 limit testing.

## Penalty Tax

- Distributions before age 59½ will be subject to a 10% early withdrawal penalty unless such distribution is made according to rules relating to one of the following exceptions:
  - Death
  - Disability
  - Substantially equal periodic payments over life or life expectancy of the participant
  - Medical expenses in excess of 10% of adjusted gross income
  - Separation from service at age 55 or older (one-time exception)
  - Distributions to a nonparticipant pursuant to a qualified domestic relations order (QDRO)

## Target Market

- SIMPLE 401(k) plans are more attractive than a SIMPLE IRA plan for businesses interested in loan provisions, more restrictive hours requirements for eligibility, exclusion of employees under age 21 or participant bankruptcy protection under the Employee Retirement Income Security Act (ERISA).
- Employers with 401(k) plans in force should consider moving to a SIMPLE 401(k) plan if the employer is struggling to meet top-heavy requirements, is unable to meet nondiscrimination testing requirements, or if highly compensated employees are unable to defer up to \$12,500 due to failing 401(k) plan discrimination testing requirements.

<sup>1</sup> A plan is considered to be top heavy if the employer's contributions to highly compensated employee accounts are greater than 60% of employer contributions to non-highly compensated employee accounts.

# SIMPLE IRA and SIMPLE 401(k): Major Differences

	SIMPLE IRA	SIMPLE 401(k)
<b>Employee Eligibility Requirements</b>	Any employee earning \$5,000 or more in any two prior years and expected to earn \$5,000 in the current year	Any employee earning \$5,000 and 21 years of age or with 1,000 service hours in a prior year (may be less if allowed by plan document)
<b>Employee Deferral Limit</b>	Lesser of \$12,500 per plan year or 100% of compensation	Lesser of \$12,500 per plan year or 100% of compensation
<b>Employer Contribution Limit</b>	If employer elects 3% deferral option, up to \$12,500 annually	If employer elects 3% deferral option, up to \$8,100 annually (\$270,000 x .03). If employer elects 2% deferral option; up to \$5,400 annually (\$270,000 x .02)
<b>Participant Loans</b>	Not permitted	Permitted if allowed by plan document
<b>Rollovers</b>	To IRA without penalty only after two years; may roll into another SIMPLE IRA prior to two years	To IRA or qualified plan immediately
<b>Excise/Penalty Tax</b>	Withdrawals before age 59½ subject to 10% tax (25% if in first two years)	Withdrawals before age 59½ subject to 10% tax
<b>Competitive Advantage</b>	Minimal administration expenses, and no IRS Form 5500 filings or IRC Sec. 415 limit testing	Loans permitted; may have more restrictive eligibility requirements; exclusion of employees under 21; and bankruptcy protection under ERISA

# Defined-Benefit Pension Plans

**Defined-Benefit Pension Plan** – *Retirement plan funded with employer contributions based on amount required to provide determinable future income benefits to plan participants*

## Employer Contribution Limits

- Annual defined benefit amount for a participant cannot exceed the lesser of \$215,000 or 100% of the employee's highest three years' (consecutive) compensation (indexed for 2017).
- Annual compensation taken into account for qualified plans is \$270,000.
- Deduction of contributions is based on actuarial assumptions and computations. Therefore, an actuary must determine plan deductible annual contribution limit.
- Gains in excess of actuarial assumptions may be used to reduce contribution in the following year.

## Key Points

- Allows an employer to create a substantial retirement income benefit for employees.
- Can be used in conjunction with, or instead of, a defined contribution plan.

**412(e)(3) Plan** – *A defined-benefit plan funded exclusively with life insurance and/or annuities to create a guaranteed retirement income benefit*

## 412(e)(3) Plan Opportunities

- Exempt from minimum funding requirements because 412(e)(3) plans are fully insured.
- Tax-deductible contributions not subject to the funding limitations of a traditional qualified plan; as a result, contributions are generally larger and more flexible.
- Easier to implement, less costly and less administratively complex to employ than a typical defined benefit pension plan.

## How it Works

The plan trustee purchases a combination of life insurance and annuities inside the 412(e)(3) plan to fund future retirement income benefits for plan participants. Plan participation begins when an employee has met eligibility requirements and ends no later than employee's retirement date as specified in the plan document.

## Target Market

Used by small businesses (often with 10 or fewer employees) that are stable, successful, profitable and have significant consistent cash flow.



# 401(a) Plans

**401(a) Plan** – *A qualified retirement plan established as a profit-sharing plan, pension plan or money-purchase plan*

## *Profit-Sharing Plan*

### Employer Contribution Limits

- Lesser of \$54,000 or 100% of employee's salary (indexed for 2017):
  - Employer contributions are optional and made in years elected at the employer's discretion.
  - Employer contributions can be discretionary and/or matching (based on employee's 401(k) salary deferral percentage).
  - Employer contributions are deductible up to 25% of employee's compensation, with a 2017 maximum of \$54,000.
  - Employer contributions must be "substantial and recurring."

### Employee Deferral Limit

- Nondiscriminatory percentage of pre-tax contributions as stated in plan document:
  - Employee deferrals permitted by plan document are 100% vested immediately.

### Types of Profit-Sharing Plans

- Age-weighted profit-sharing plan:
  - Designed to allow contributions to be allocated among employees in amounts based on each employee's age.
  - Age-weighted allocations may work well if there is a significant age disparity between business owner(s) and employees.
- New comparability (cross-tested) profit-sharing plan: plan designed to allow allocation of contributions to employees in varying amounts based on each employee's age, compensation and/or job classification.

# 401(a) Plans *(continued)*

## *Money-Purchase Plan*

### Employer Contribution Limits

- Lesser of \$54,000 or 100% of employee's salary (indexed for 2017)
  - Employer contributions are mandatory and based on a percentage of the employee's salary.
  - Employer contributions only: employee contributions are not permitted.

### Key Points

- Loans are permitted if allowed by the plan document.
- If employee separates from service, any vested portion may roll over to an IRA established by the former employee, or to a new employer's retirement plan if permitted by new employer's plan.
- May be less desirable than a profit-sharing plan because employee salary deferrals into a money purchase plan are not allowed and annual employer contributions are mandatory.

### Penalty Tax

- Distributions before age 59½ will be subject to a 10% early withdrawal penalty except when due to:
  - Death
  - Disability
  - Substantially equal periodic payments over participant's life or life expectancy
  - Medical expenses in excess of 10% of participant's adjusted gross income
  - Separation from service after age 55
  - Distribution to a nonparticipant pursuant to a qualified domestic relations order (QDRO)

### Target Market

- Employers seeking to enhance retirement benefits and attract and retain high-quality employees.
- Small businesses (fewer than 100 participants) may be eligible for a tax credit up to 50% of the first \$1,000 of start-up, administration and education expenses for the first three years of a new retirement plan.

# 401(k) Plans

**401(k) Plan** – *A qualified profit-sharing plan with a salary deferral feature*

## Employer Contribution Limits

- Lesser of \$54,000 or 100% of employee's salary (indexed for 2017):
  - This limit includes what the employee contributes by elective deferral into their account.
  - Employer contributions can be discretionary and/or matching (based on employee's salary deferral percentage).
  - Employer contribution is not mandatory unless specified in the plan document or if plan is top heavy; however, if a plan is top heavy, the highest employer contribution percentage is 3% for all eligible employees.
  - Vesting schedule of employer contributions stated in plan document.

## Employee Deferral Limit

- \$18,000 per plan year (indexed for 2017) up to 100% of compensation:
  - Employee contributions are 100% vested immediately and cannot be forfeited.
  - Employees age 50 (by the end of the calendar year) or older are permitted to make an additional \$6,000 catch-up elective deferral contribution for 2017, for a total annual elective deferral contribution limit of \$24,000.

## Key Points

- Loans are permitted if allowed by the plan document.
- If employment changes, participant's vested portion may roll over to a plan offered by new employer, if permitted by new employer's plan.
- If employee separates from service, their vested portion may roll over to an IRA.
- Withdrawals from 401(k) plans are substantially restricted, since its purpose is retirement funding.
- Distributions may be made under specific conditions, including:
  - Participant (employee) reaches a designated age, and/or number of years of service and plan document allows in-service distributions.
  - Participant (employee) becomes disabled (as defined by the Internal Revenue Code).
  - Distribution is paid to a beneficiary at participant's death.
  - In-service withdrawals taken as permitted by Internal Revenue Code and plan document.
  - A qualified domestic relations order (QDRO) directs a required distribution.
  - Separation from service.

# 401(k) Plans *(continued)*

## IRS-Required Testing

- **Top-Heavy Test:** A plan is considered to be top heavy if the employer's contributions to key-employee accounts are greater than 60% of the employer contributions to non-key-employee accounts.
- **Actual Deferral Percentage (ADP) Test:** An extra nondiscrimination test required by 401(k) plans that restricts highly compensated employees from deferring a percentage of their annual salary far above the percentage deferred by non-highly compensated employees; the plan must satisfy either the 1.25% or the 200%/2% ADP test.
- **Actual Contribution Percentage (ACP) Test:** Employer matching contributions and after-tax employee contributions to the profit-sharing portion of a 401(k) plan must meet similar nondiscrimination testing; the plan must satisfy either the 1.25% or the 200%/2% ACP test.
- **Safe Harbor Opportunity:** Highly compensated employees may contribute the full \$18,000 deferral limit permitted for 2017 if a 401(k) plan satisfies one of the following safe harbor requirements:
  - Matching contribution by the employer of 100% of the first 3% deferred and 50% of the next 2% deferred
  - 3% nonelective employer contribution to all eligible employees (this option is the default selection for top-heavy plans)

## Penalty Tax

- Distribution before age 59½ subject to a 10% early withdrawal penalty unless it qualifies for one of the following exceptions:
  - Death
  - Disability
  - Substantially equal periodic payments over life or life expectancy
  - Medical expenses in excess of 10% of adjusted gross income
  - Separation from service at age 55 or older
  - Distributions to nonparticipants pursuant to a qualified domestic relations order (QDRO)

## Target Market

- Employers seeking a proven way to attract and retain high-quality employees.
- Small businesses (fewer than 100 participants) may be eligible for a tax credit up to 50% of the first \$1,000 of start-up, administration and education expenses for the first three years of a new retirement plan.

## Designated Roth 401(k) Accounts

401(k) designated Roth contributions are after-tax salary contributions accepted by 401(k) plans allowing such contributions.

- If a 401(k) plan adopts a designated Roth account feature, employees can direct some or all of their elective contributions to be designated Roth account contributions, which are included in gross income rather than being classified as traditional, pre-tax elective deferral contributions.
- Designated Roth account contributions must be kept separate from previous and current 401(k) pre-tax elective deferral contributions; a separate, designated Roth account must be established for each participant making contributions to a designated Roth account.
- Once a payment is designated as a Roth account contribution, it cannot be changed later to a pre-tax elective deferral 401(k) contribution.

The American Taxpayer Relief Act of 2012 (ATRA) expanded in-plan Roth conversion rules for 2014 and later years. Participants in 401(k), 403(b) and 457 retirement plans offering a designated Roth account can convert any non-Roth account to a Roth account within the plan, regardless of whether the converted funds can be distributed from the retirement plan at the time of conversion. This new rule does not allow transfers out of a plan to a Roth IRA. As under prior law, converted amounts are taxed as ordinary income but not subject to mandatory withholding or 10% early withdrawal penalty.

**Employee Contribution:** An employee can make contributions to both a designated Roth 401(k) account and to a pre-tax 401(k) account in the same year and in any proportion. However, the combined amount contributed in any one year is limited by IRC Sec. 402(g) — \$18,000 for 2017 (plus an additional \$6,000 catch-up contribution if age 50 or older) for a total contribution limit of \$24,000.

**Employer Contribution:** Only an employee's designated Roth elective deferral contributions can be made to a designated Roth 401(k) account.

**Penalty-free Withdrawals:** Earnings withdrawn are included in gross income unless the participant has maintained the designated Roth 401(k) account for five years and has attained age 59½, or is disabled.

## 401(k) Mirror Nonqualified Deferred Compensation Plan

This may be offered in conjunction with a 401(k) plan and may involve a corporate-owned life insurance policy. These plans allow highly compensated employees to reduce their taxable wage base by deferring receipt of pre-tax compensation and are not restricted by rules governing qualified retirement plans. An employer cannot take a deduction of the salary amount deferred in the year of deferral. An employer's deduction is taken when the benefit is paid to the employee.

- Primary goal is to attract, retain, reward and retire key employees by providing a deferral option in addition to amounts deferred into a traditional 401(k) plan.
- A rabbi trust is sometimes used to segregate the assets in the event of a change in company ownership or management.
- In order to avoid ERISA's funding and vesting requirements, participants in the plan must be limited to a "select group of management or highly compensated employees" (i.e., a top-hat plan).

# 403(b) Plans

**403(b) Plan** – *A tax-sheltered investment used to accumulate retirement savings, typically through salary deferral*

## Eligibility

- Available to 501(c)(3) tax-exempt organizations, public schools and universities (for-profit corporations cannot establish a 403(b) plan):
  - 501(c)(3) organizations: nonprofit groups, with special tax exemptions, organized and operated for religious, charitable, scientific or educational purposes at zero-profit levels.
  - Public schools: institutions must maintain a faculty, curriculum and student body (i.e., not available for home schooling situations).

## Employer Contribution Limits

- Lesser of \$54,000 or 100% of employee's salary (indexed for 2017):
  - Employer contributions can be discretionary and/or matching (based on employee's 403(b) deferral).
  - A vesting schedule for employer contributions is included in the 403(b) plan document.

## Employee Contribution Limits

- The lesser of \$18,000 per plan year (indexed for 2017) or 100% of compensation:
  - Employee contributions are 100% vested immediately and cannot be forfeited.
  - Employees age 50 (by the end of a calendar year) or older are permitted to make an additional \$6,000 catch-up contribution for 2017 for a total contribution limit of \$24,000.

## ERISA vs. Non-ERISA 403(b) Plans

ERISA 403(b) Plans	Non-ERISA 403(b) Plans
Allow for both employee and employer contributions	Typically allow for employee contributions only, unless plan document states otherwise
Employee may be subject to a vesting schedule	Employee contributions are made by voluntary salary reduction
Employee may be subject to age and service requirements to participate	Individual accounts (participants direct their own investments)
Administrator is responsible for plan and IRS reporting	Sometimes known as a tax-sheltered annuity (TSA)

## Key Points

- A written 403(b) plan document is required for tax years beginning after Dec. 31, 2009.
- 403(b) contract exchanges/transfers after Sept. 24, 2007, require the issuer to maintain the contract under a written plan document and enter into an information-sharing agreement with the sponsoring employer.
- Contracts received in a Rev. Rul. 90-24 exchange/transfer before Sept. 25, 2007, are grandfathered, but grandfathered treatment is not available if the contract is exchanged for another 403(b) contract after Sept. 24, 2007.
- Incidental life insurance, unless grandfathered, cannot be part of a 403(b) plan.
- Loans are permitted if allowed by plan document.
- If employee separates from service, their vested portion may be rolled over to an IRA.
- Withdrawals from 403(b) plans are substantially restricted by the Tax Reform Act of 1986.
- Distributions (other than loans) may be made under the following conditions:
  - Participant (employee) must be at least 59½ years old and plan document allows in-service distributions
  - Participant (employee) becomes disabled as defined by the Internal Revenue Code.
  - Participant (employee) separates from service with employer.
  - Participant needs a financial hardship withdrawal (10% excise tax may apply if employee is under 59½).
  - Distribution is paid to a beneficiary following participant's death.
  - Participant (employee) takes a qualified reservist distribution.

## Penalty Tax

- Distributions before age 59½ are subject to a 10% early withdrawal penalty unless such distribution qualifies for one of the following exceptions:
  - Death
  - Disability
  - Substantially equal periodic payments over life or life expectancy
  - Medical expenses in excess of 10% of adjusted gross income
  - Separation from service after age 55 (one-time exception)
  - Distributions to a nonparticipant directed by a qualified domestic relations order (QDRO)

## Target Market

Schools, hospitals, religious organizations, charities and colleges/universities.

# Nonqualified Life Insurance Sales Concepts

## *Insurance-Based Retirement Program*

### Goal

To supplement retirement income and provide life insurance protection in the event of an employee's premature death.

### How it Works

- The individual or employer pays the premium to fund a variable or traditional life insurance policy owned by the employee.
- Employee names their desired policy beneficiary or beneficiaries.
- At retirement, the policy owner may take partial surrenders (up to the amount of total premiums paid) and loans from the policy on a tax-advantaged basis (if set up properly) to supplement retirement income.
- These statements assume the life insurance contract remains in force and qualifies as life insurance under section 7702 of the Internal Revenue Code, and is not a Modified Endowment Contract (MEC) under section 7702A. Loans and partial surrenders from a MEC are generally taxable and, if taken before age 59½, may be subject to a 10% penalty tax. Loans and partial surrenders reduce the amount of any death benefits payable.
- At the insured's death, the policy beneficiaries receive the death benefit proceeds income tax free.

### Benefits/Advantages

- Tax advantages: The withdrawal method (i.e., first-in, first-out) depletes the principal in the policy (tax-free) first, followed by policy loans.

#### **Caveat:**

In order for the life insurance policy to retain its tax advantages, it must remain in force and not be classified as a MEC. If the policy does lapse, the gain/earnings are taxed as ordinary income.<sup>1</sup>

- Partial surrenders are distributed on a first-in, first-out basis (after-tax premiums first, as long as policy remains a non-MEC).
- Beneficiaries are provided replacement income in the event of an employee's premature death.
- Beneficiaries receive death benefit proceeds income tax free (IRC section 101(a)).
- No additional fees, administration or discrimination testing is required.
- Liberal funding levels (unlike a qualified plan).
- Cash value grows tax deferred, providing greater growth potential.
- Cash value in the policy may be available for emergencies or financial planning needs (e.g., college funding, mortgage acceleration).

### Target Market

Insurance-based retirement programs can be ideal for sole proprietors, small business owners or high-net-worth individuals who have maximized other retirement plan contributions and would like to supplement their retirement income in a tax-advantaged manner.

<sup>1</sup> This assumes contract remains in force, qualifies as life insurance under section 7702 of the Internal Revenue Code, and is not a modified endowment contract (MEC) under section 7702A. Loans and partial surrenders from a MEC are generally taxable and, if taken before age 59½, may be subject to a 10% penalty tax. Loans and partial surrenders will reduce any death benefits payable.



# Nonqualified Life Insurance Sales Concepts *(continued)*

## *Executive Bonus Plan — IRC Section 162*

### Goal

To retain and reward key employees by making a taxable contribution into a variable or traditional life insurance policy owned by the insured employee. The employer premium contribution is tax deductible by the employer and is a taxable bonus to the employee.

### Estate Planning

If the employee desires to exclude the policy from his or her gross taxable estate upon death, the initial applicant and owner of the policy should be a third party (e.g., spouse or trustee), and the employee should not retain any incidents of ownership in the policy.

### Benefits to Employer

- Employer rewards and retains key employees, while supplementing their retirement.
- Selective participation is allowed without violating ERISA nondiscrimination rules.
- Premiums paid by the employer may provide an immediate employer tax deduction.
- Administration cost is minimal due to the simplicity of setup and implementation.
- Amounts of coverage on various employees/executives can differ.
- Plans can be established or terminated without IRS notice, approval or restriction.

### Benefits to Executives

- Supplemental retirement assets can be accumulated.
- Beneficiaries receive income-tax-free death benefit proceeds (IRC section 101(a)).
- Key employee/executive controls and owns the life insurance policy.
- Cash value grows income tax deferred.

### Key Points

- Employer cannot be the owner or a beneficiary of the insurance policy.
- The premium paid by the employer is considered additional compensation to the employee and will be taxed as ordinary income to the employee.
- The premium paid by the employer must be considered “reasonable compensation” when added to all other compensation for the employer to receive an income tax deduction.
- If the goal is to retain key personnel for a period of time, a written agreement between the employer and employee, such as a Restricted Employee Benefit Agreement (REBA), may help.

### Target Market

- C Corporations
- S Corporations
  - S Corporations may want to consider this as an alternative to a split-dollar plan
- Partnerships
- Limited Liability Companies
- Sole proprietorships
- Small business owners

# Nonqualified Life Insurance Sales Concepts *(continued)*

## *Split-Dollar Plan*

### Goal

To retain and reward key employees by splitting the cost of a life insurance policy between employer and employee while accumulating cash value on a tax-deferred basis.

### Benefits to Employer

- Discrimination in favor of owners and key employees is permitted.
- The employer's share of premiums is secured/protected within the policy.
- The plan is exempt from ERISA vesting, funding and participation rules.

### Policy Ownership

- Endorsement method: The employer owns the policy and the employee's interest is recorded as a policy endorsement.
  - A written endorsement is typically filed with the insurance company issuing the policy.
  - Employer is required to provide a plan summary to all participants.
  - Under current regulations, the endorsement method is taxed under the traditional split-dollar agreement economic benefit rules described below:
    - Employer pays the premiums required.
    - Employee is taxed on the economic benefit of life insurance coverage to the extent that the employer pays the premium and is not repaid by the employee.
    - The economic benefit includes the value of current life insurance protection (Table 2001 values or actual term insurance rates).
- Loan regime method: The employee owns the policy, and the employer's interest is secured by a collateral assignment of the contract.
  - Under current regulations, funds provided by the employer under the loan regime method will be treated as a series of below-market-rate loans if the employee is obligated to repay the funds.
  - If the employee is not obligated to repay the loan, the funds will be treated as current compensation to the employee.

### Target Market

Proven vehicle for a C Corporation or a closely held business desiring to provide additional life insurance or supplemental retirement resources for a limited and select group of key employees.

# Nonqualified Life Insurance Sales Concepts *(continued)*

## *Deferred Compensation Plan — Supplemental Executive Retirement Plan (SERP)*

### Goal

To retain and reward talented/valuable key employees by providing an additional incentive (i.e., deferred compensation) to them and their families for remaining employed with the company.

### How it Works

A corporation purchases a life insurance policy to help fulfill its contractual agreement with certain key employees. The policy cash value and death benefit may be used to offset the employer's financial contributions.

- A deferred compensation agreement is typically designed to guarantee key employees a prearranged payout at retirement (or to their survivors if the employee dies prior to retirement), if they remain employed by and fulfill their contractual obligations to the employer.
- A corporation (employer) owns the policy and uses it to informally fund deferred compensation benefits.
- A corporation (employer) is required by contract to provide future benefits to key employees (or the employees' survivors) if they meet their contractual obligation to the employer.
- If key employees do not fulfill their commitment, they forfeit the deferred compensation to employer.

### Target Market

- Used by C Corporations to compensate executives while retaining maximum control over the policy. Cost recovery by the corporation for its life insurance expense may be part of a plan design. A tax deduction is available when benefits are paid out to key employees.
- Popular with closely held businesses interested in providing a substantial benefit to owners and key personnel without including all employees.

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