

Tax Advantaged Accumulation Plan



**Thomas E. Bonhag, CFP, CLU, ChFC,
CAP®, Certified Financial Planner**

NFP National Madison

340 Madison Avenue, 21st Floor | New York, NY | 10173

P 212.878.1689 | F 212.786.5597

tbonhag@nationalmadison.com

www.nationalmadison.com



The Challenges

Much of your company's success depends on the talents of your executives. How can you encourage high caliber executives to stay the course?

Keeping the people who keep you in business can be easier said than done. Your key executives are not simply looking for a pat on the back. They want to see in tangible ways – preferably financially driven – that you recognize and appreciate their efforts in making your company a success. But higher pay is not the only answer. Offering a competitive benefit program for your top executives can give your company an advantage in recruiting, motivating and retaining the talented people who are the driving force behind your business.

Many executives feel unprepared and apprehensive when it comes to retirement planning. They need solutions to help them bridge the “retirement gap.”

As you know, the government imposes monetary limits on the amount that employees and employers may contribute toward tax-favored qualified plans such as an IRA, 401(k) or 403(b). These limits leave many highly compensated executives (HCEs) who rely primarily on qualified plans for retirement without enough savings to sustain their current standard of living.

While most of your rank-and-file employees can achieve full income replacement with qualified plans, caps on these plans and Social Security benefits often leave your top executives retiring at only 30 percent to 50 percent of their salary. These limitations create a retirement gap for your top executives.



What Causes the Gap?

A summary of 2010 tax laws adversely affecting the highly compensated:

401(k)/403(b) Retirement Plans

- \$110,000 of wages classifies an employee as “Highly Compensated” (IRC Sec. 414(q)(1)(B))
- \$16,500 maximum annual deferral – \$22,000 if age 50 or older (IRC Sec. 402(g)(1))
- 401(k) discrimination testing may limit deferrals (2 percent nondiscrimination limit)
- Company contributions limited to the lesser of 100 percent of compensation or \$49,000 (IRC Sec. 415(c)(1)(A))
- \$245,000 maximum eligible compensation limit (IRC Sec. 401(a)(17))
- 10 percent tax penalty for early withdrawals

Defined Benefit Pension Retirement Plans

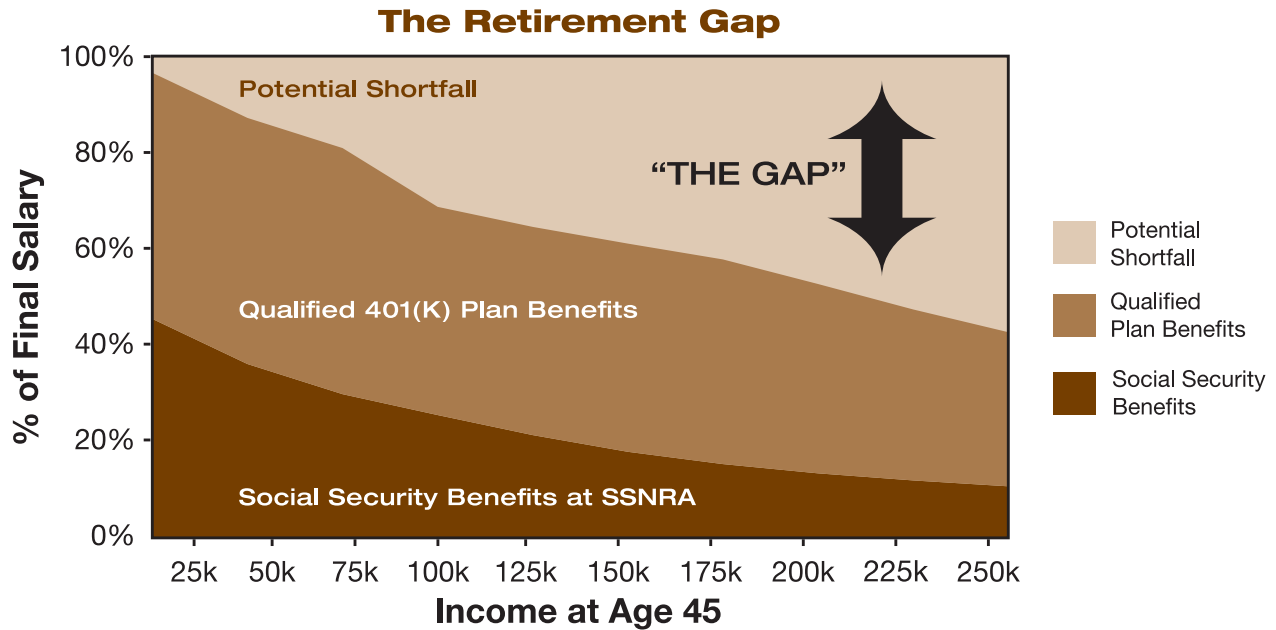
- \$195,000 maximum benefit payout (IRC Sec. 415(b)(1)(A))
- \$245,000 maximum eligible compensation limit

Individual Retirement Accounts (IRAs)

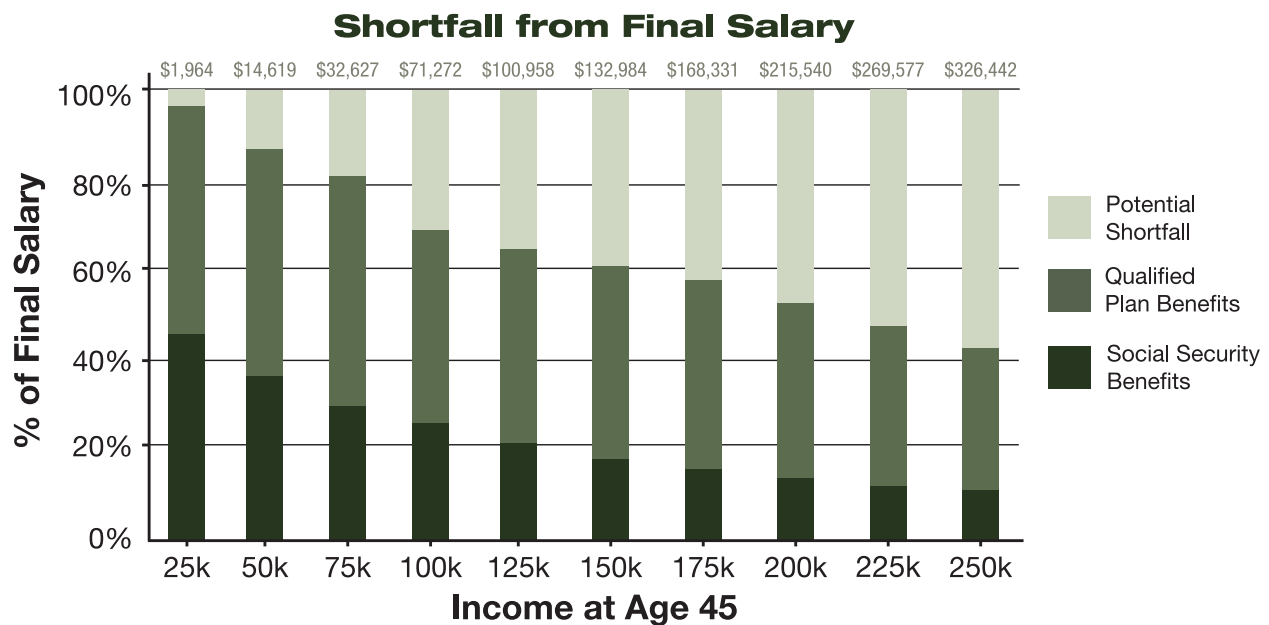
- Employees face reduced or phased out contributions to an IRA account if participating in a qualified retirement plan (IRC Sec. 219)
- For married, adjusted gross income (AGI) greater than \$89,000 but less than \$109,000
- For single, AGI greater than \$56,000 but less than \$65,000
- \$5,000 maximum contribution (\$6,000 if age 50 or older)
- Roth IRA contributions phased out \$120,000 of AGI for an individual or \$177,000 for married filing jointly
- 10 percent tax penalty for early withdrawals

The Retirement Gap and Replacement Ratios

The chart below illustrates the retirement gap that executives today might expect from their Social Security and qualified plan benefits.¹ As earnings increase, the shortfall increases. For example, a 45-year-old executive currently making \$250,000 can expect qualified plan and Social Security benefits to provide roughly 43 percent of his/her final salary.



The chart below demonstrates the potential total shortfall as a dollar amount.¹ For example, a 45-year-old executive currently making \$150,000 per year will need to generate approximately \$133,000 annually from other sources to replace 100 percent of his/her final salary.



It is difficult, if not impossible, for highly compensated executives to rely solely on qualified plans to generate the income required to bridge the gap and meet the desired retirement goal. Executives at higher income levels must turn to other alternatives, such as personal savings plans, participation in nonqualified plans or a combination of both, to meet their post-retirement income needs.

How Can a Tax Advantaged Accumulation Plan Help Bridge the Gap?



A tax advantaged accumulation plan (TAAP) can provide significant benefits to help your executives accumulate greater capital for retirement. At the same time, it can enhance your overall executive benefit program by offering additional incentives and retirement benefits, incorporating special features intended to retain the services of your top executives.

The plan is structured and priced to offer executives a savings opportunity that can provide greater capital for retirement while also providing needed life insurance benefits. The beauty of a TAAP is that:

- Premiums are paid with after-tax dollars
- Policy cash values accumulate on a tax-deferred basis
- Benefits can be received income tax-free

Potential Impact of Taxes

Taxable vs. Tax Advantaged Assets								
	Taxable Asset	Life Insurance Asset	Taxable vs. Life Insurance Difference		Taxable Asset	Life Insurance Asset	Taxable vs. Life Insurance Difference	Taxable vs. Life Insurance Net to Heirs
IRR ANALYSIS @ AGE 80				VALUES ANALYSIS — 45-YEAR-OLD				
				Funding Amount:	\$10,000	\$10,000	\$0	
Gross Rate:	7.50%	7.50%	0.00%	Year 1:	\$10,488	\$10,349	(\$139)	\$208,186
Taxes @ 35%:	-2.63%	0.00%	-2.63%	Year 10:	\$131,144	\$131,454	\$311	\$208,636
Other Insurance Costs:	0.00%	-0.67%	-0.67%	Year 20:	\$342,233	\$396,634	\$54,401	\$133,728
*Net Internal Rate of Return	4.87%	6.83%	1.96%	Year 35:	\$698,878	\$1,158,810	\$459,931	\$517,872

*Assumes 45-year-old male, \$10,000 fixed insurance policy until age 65. All guarantees are subject to the claims paying ability of the issuing insurance company.

The hypothetical case study results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required for some investments. No representation is made as to the accurateness of the analysis.

Tax Advantaged Accumulation Plan Advantages

Benefits of a TAAP to the Executive

- High-income executives have more income to protect in the event of a premature death. Beneficiary will receive income tax-free death benefit.
- Executive owns the life insurance policy.
- Policy cash value grows on a tax-deferred basis and can be accessed tax free² to supplement retirement or other income needs.
- Policy may be maintained during a period of disability or at retirement with the costs of insurance being paid from policy values.
- No surrender charges.
- Depending on the state, the policy cash values may be exempt from the claims of individual creditors.

Benefits of a TAAP to the Company

- Provides a program to reward, retain and recruit key talent.
- Freedom to select participants among your highly compensated management.
- No impact on existing plans.
- IRS approval not required; avoids most of the cost and administrative requirements associated with establishing a qualified plan under ERISA.
- A TAAP has little or no cost to employer to implement.
- Provides an attractive executive benefit program to help executives attain greater cash accumulation than taxable alternatives earning the same rate of return.

Comparison of TAAP and Other Plans

A TAAP offers maximum flexibility in designing a benefit program to retain, reward and recruit key executives to your organization.

	Qualified Plans	Nonqualified Deferred Comp. Plans	TAAP
Can management choose who will participate in the plan?	No	Yes ³	Yes
Can the plan discriminate in favor of highly compensated executives?	No	Yes	Yes
Can benefits vary for different participants?	No	Yes	Yes
Can new executives be added to or excluded from the plan at management's option?	No	Yes	Yes
Does federal law set minimum vesting requirements?	Yes	No	No
Is the plan required to file an annual report form with the U.S. government? ⁴	Yes	No	No
Is a trust or other formal funding vehicle required?	Yes	No	No
Is the plan fully isolated from corporate creditors in case of company insolvency?	Yes	No	Yes
Corporate booked liability?	No	Yes	No
Corporate control over assets?	No	Yes	No
Current corporate tax deduction?	Yes	No	Yes
Current employee tax?	No	No	Yes
Potential tax-free retirement income?	No	No	Yes
Complex administration?	Yes	Yes	No

Plan Mechanics

In a world where executive compensation and supplemental benefits are becoming increasingly complex, a TAAP is refreshingly simple.

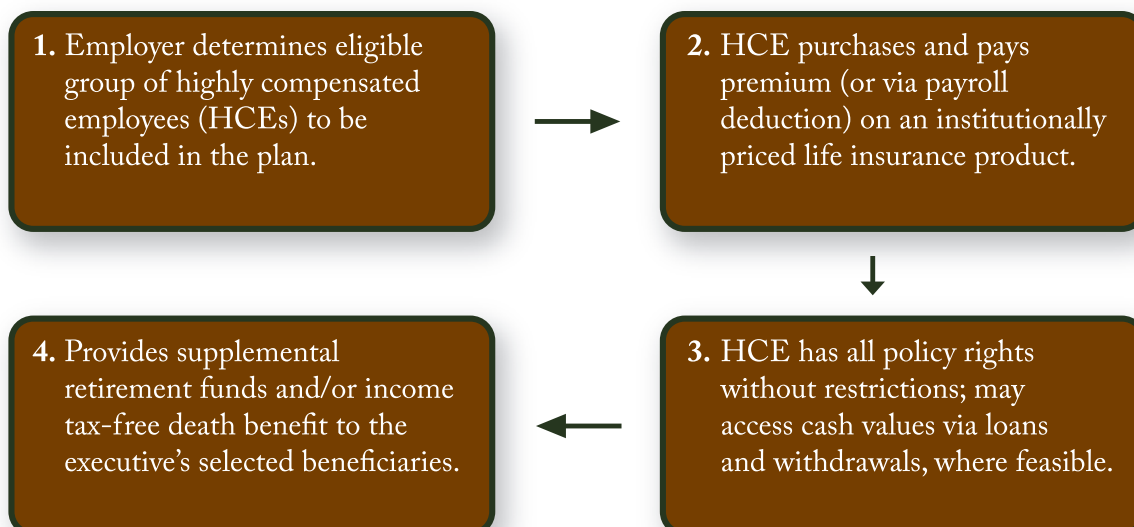
To establish a TAAP, a company determines the eligible group of executives to be included in the plan. The executive purchases an institutionally priced life insurance product and pays the premium (or via payroll deduction). Unlike other nonqualified plans that are informally funded, the executive – not the company – owns the policy and TAAP funding vehicle (the life insurance policy).

The executive has all policy rights without restriction and may access policy cash values through loans and withdrawals, where feasible.

The insurance pays income tax-free death benefit to the executive's selected beneficiaries. The sponsoring company may also make contributions to the plan as well.



How the Plan Works



Plan Implementation and Ongoing Plan-level Administration

An executive benefit plan does not have to be complicated to be effective. A TAAP offers meaningful benefits and plan features in a simple design.

Plan Communication and Enrollment

The manner in which the executive benefit program is introduced to the executives can make a lasting impression. To encourage participation and to obtain the full value of the benefit program, it must be communicated effectively. Otherwise, your executives may not fully appreciate the program.

Plan-level Administration

Administration for a TAAP is also a simple process. The life insurance carrier will provide a list bill for the sponsoring company and executives will pay the premium through a payroll deduction arrangement established by the employer. The carrier also provides ongoing policyholder service during the executive's working years and beyond.

Footnotes

¹ Maximum contributions in the qualified plan, increased by a 3 percent COLA in \$500 increments. Note: highly compensated executive deferrals have been capped at 8 percent.

Assumptions:

- a. Employer matches 50 percent up to 6 percent of eligible compensation;
- b. Eligible compensation increases at 3 percent annually in \$5,000 increments;
- c. Actual compensation increases at 4 percent;
- d. 401(k) assets accumulate at 8 percent;
- e. Account balance amortized at retirement at 8 percent for 15 years.
- f. Retirement age 67.

Social Security Administration (SSA) Benefit Calculator at: www.ssa.gov/planners/calculators.htm. SSA benefit calculator projecting future salary increases at approximately 4 percent. Full Social Security benefits available at age 67.

² Withdrawals made during the first 15 years could result in unfavorable LIFO taxation under IRC Section 7702(f)(7) "force-out" rules. Withdrawals or surrenders in excess of cost basis may be taxable. Lapsing a policy with an outstanding loan results in the loan, and any accrued interest, being treated as a distribution, which may be taxable. Modified endowment contracts (MEC's) are taxed differently and are not suitable for this program if surrenders or loans are anticipated. Please check policy illustrations to see if the policies being considered are MEC's. Certain changes to a non-MEC policy could result in the policy becoming a MEC. Professional tax advisors should be consulted. Any loans, withdrawals or partial surrenders will reduce cash values and death benefits.

³ Plan participation in a nonqualified deferred compensation plan must, however, be limited to a select group of management or highly compensated executives. Consult a qualified legal adviser.

⁴ Under a deferred compensation plan, an initial notification must be filed with the Department of Labor.

Thomas E. Bonhag offers securities and investment advisory services through AXA Advisors, LLC (NY, NY 212-314-4600), member FINRA/SIPC, and offers annuity and insurance products through AXA Network Insurance Agency, LLC and its affiliates.

This material was created by National Financial Partners Corp., its subsidiaries, or affiliates for distribution by their Registered Representatives, Investment Adviser Representatives, and/or Agents. This material was created to provide accurate and reliable information on the subjects covered. It is not intended to provide specific legal, tax or other professional advice. The services of an appropriate professional should be sought regarding your individual situation.

Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS under Circular 230, we inform you that any U.S. Federal tax advice contained in this communication, unless otherwise specifically stated, was not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code or (2) promoting, marketing, or recommending to another party any matters addressed herein.

