

412(i) aka: 412(e)(3) Defined Benefit Pension Plan Frequently Asked Questions

What is a 412(i) aka: 412(e)(3) defined benefit pension plan?

A 412(i) aka: 412(e)(3) defined benefit pension plan is the only defined benefit plan that is exempt from the minimum funding requirements of Section 412(i) aka: 412(e)(3) of the Internal Revenue Code. It is referred to in IRS regulations as an “insurance contract plan”. This type of plan enjoys certain advantages over the traditional defined benefit plan.

A 412(i) aka: 412(e)(3) plan is worth exploring if you are the owner of a small business with few or no employees.

A 412(i) aka: 412(e)(3), when compared to a traditional defined benefit plan, will produce:

- > Larger initial deductions
- > More stability in the contribution level
- > Simpler plan administration, and
- > A secure promise of future benefits guaranteed by an insurance company

What advantages does a 412(i) aka: 412(e)(3) insurance contract plan offer over a traditional defined benefit plan?

- > Does not require an enrolled actuary
- > Is not subject to the full funding limitation tests of a defined plan
- > Is required to use the contract guarantees as funding assumptions, thus shielding them from IRS attack as unreasonable funding assumptions
- > Can be designed to eliminate the potential of excess plan assets that, in a traditional plan, would be subject to taxes and penalties of 80% or more upon termination of the plan
- > Produces an understandable accrued benefit since it is simply the cash value of the contracts funding that participant’s account
- > Creates larger initial deduction than a traditional plan since the funding assumptions are required to be much more conservative
- > Provides retirement benefits that are guaranteed by the insurance company and not just the financial strength of the particular employer providing the plan

What requirements must be met to qualify as a 412(i) aka: 412(e)(3) insurance contract plan?

The major requirements under section 412(i) aka: 412(e)(3) of the Internal Revenue Code are:

- > The plan must be funded exclusively with annuity products, or a combination of life insurance and annuity products, issued by an insurance company.
- > The benefits provided each individual must be equal to the values provided in the contracts and guaranteed by the insurance carrier.
- > Life insurance dividends and excess annuity must be used to reduce the following year’s plan contribution.
- > No policy loans are allowed under the contracts.