

SELECT 79

SELECT 79 is a group life program marketed under IRC Section 79, whose original design was to permit successful business owners and professionals to make significant tax deductible contributions to purchase permanent life insurance, both on themselves and key employees. This was done without incurring the high cost of covering ancillary employees often associated with qualified plans.

Historically, this program was marketed very successfully to medical and dental professionals where qualified plans were not viable. Section 79 plans worked well because underlying group coverage was what most employees were satisfied with as it required no out-of-pocket expense to them.

These Section 79 programs were sold to many professionals using policies with strong cash value accumulations to provide supplemental income when they retired from practice.

THE AMERICAN JOBS CREATION ACT

The American Jobs Creation Act of 2004 added significant opportunities to market this program to business owners and senior executives of companies since the Act's provisions severely curtailed benefits derived from non-qualified deferred compensation plans which had been used previously for years as a "golden handcuff" for specific executive groups.

Although funded by the company, these policies are personally owned and provide continuing tax-advantaged benefits to the insured/owners.

SELECT 79 offers a high degree of flexibility, is easy to administer, with minimal reporting required.

THE PROPOSED REGULATIONS

- In February of 2004, new IRS guidelines were issued which included valuation guidelines for the taxation of a life insurance policy. Prior to the issuance of these guidelines, the “cash value” of the policy was used in calculating the cost of permanent benefits under the Section 79 regulations.
- The proposed regulations provide that the “fair market value” of a policy should be used in these calculations. Many advisors believe that the accumulation value meets the “safe harbor” definition in the proposed regulations.
- We have taken the proposed new regulations into account in our prototype product design and the calculations required under the Section 79.
- The amount included in the participant’s taxable income is approximately 65% of the annual premium/contribution paid by the corporation. The corporation deducts 100% of its contribution.
- While the insurance community as a whole believes that something less than the “accumulation” value will be approved in the final regulations, we have used that value in our product design.

Our adherence to the fair market value “safe harbor” guidelines in our product design assures compliance with the proposed regulations.

IRC Section 79 is not a “listed transaction” and therefore would not be characterized as a tax shelter by the IRS.

THE CONCEPT

IRC Section 79 permits a corporation to provide up to \$50,000 of group term life insurance for full time employees at no cost to the employee. Any amount of group term life insurance coverage in excess of \$50,000 is taxable to the employee (“other compensation”) and reported on their W-2 (IRC Section 6052). The amount to be included in the employee/participant’s income shall be calculated using the Table of Uniform Premiums (Table I) of Section 79 (79(c)—Reg. 1.79-3(d)(2)).

The total group life term cost is deductible to the corporation since the employee picks up the applicable cost in excess of the \$50,000 either by paying for the coverage or having it charged to their income.

Treasury Regulation 1.79-1 also states that the term portion of a life insurance policy that includes a “permanent benefit” can qualify as group term life insurance. The regulations define a “permanent benefit” as an economic value extending beyond one policy year-- such as cash surrender value. The cost of the permanent benefit is an amount at least equal to the amount determined by the use of the “Deemed Death Benefit” formula as outlined in the 79 regulations.

The cost of the permanent benefits under the policy, reduced by any contributions for such benefits by the employee, will appear on the employee's W-2 in the section entitled "other compensation."

A group insurance plan can be established using a single master policy, individually owned policies, or a combination of both.

SECTION 79 & CASH VALUE LIFE INSURANCE

A cash value life insurance policy issued on an individual basis can qualify under Treasury Regulation 1.79-1 if:

- 1) The policy or the employer designates in writing the portion of the death benefit which is group term life insurance.**
- 2) The part of the death benefit which is designated as group term life insurance for any policy year is not less than a certain amount, determined by a formula as stated in the regulations.**
- 3) An employee may elect to waive or drop the permanent benefits.**
- 4) The death benefit designated as group term life insurance is not reduced because of an employee's election to decline or drop the permanent benefits.**

There are important distinctions between companies that have more than 10 employees vs. those that have less than 10 employees insofar as what coverage must be provided those employees and how that coverage is medically underwritten.

SELECT 79 TARGET MARKETS

TAX AND SUPPLEMENTAL RETIREMENT INCOME PLANNING

The original "target" market for **SELECT 79** were those business owners or in particular, professionals, who had taken all the income out of their businesses or practices that they needed to sustain their lifestyles and who still had a substantial amount of pretax profits remaining in their business/practice. Their only option was to pay taxes—either at the business or personal level.

The inability to design a financially desirable pension plan is a significant problem for professional and service type businesses which is why they were our primary target market. All service type businesses—physicians, dentists, lawyers, accountants, engineers, architects, etc. remain excellent candidates to implement a **SELECT 79** program.

Any closely held business or professional practice that files their tax return as a "C" corporation is an eligible candidate for a **SELECT 79** program due to the fact that the Section 79 group insurance costs for all employees, including owners, are deductible expenses under IRC 162.

Pass through entities (S Corps, LLC's and sole proprietorships) do not qualify because group benefits attributable to owners are not deductible. However,

there are numerous planning options to address that issue and permit a **SELECT 79** plan to be established that will benefit owners of businesses.

Group term life insurance benefits for principals are fully tax deductible (provided they are structured as C corps) and the amount required to fund ancillary employee benefits is typically small when compared as a percentage of the total group life insurance benefit costs thereby maximizing the tax savings for the business owner and professional.

Over the past several years, well over 300 professionals in Phoenix alone have participated in a Section 79 program. One way Section 79 programs are being marketed are as “Roth IRA’s with a 35% tax deduction.”

Due to the fact that only 65% of the contribution is includable in the participant’s taxable income, we believe we can generate tremendous activity and success in the professional markets.

NON-QUALIFIED DEFERRED COMP REPLACEMENT

We believe that **SELECT 79** sales potential has vastly increased as a result of the passage of the American Jobs Creation Act of 2004. Non-qualified deferred compensation plans structured principally for key executives in medium and large businesses were negatively impacted by the newly passed restrictive rules and onerous penalties for non compliance.

The **SELECT 79** plan has two distinct advantages over non-qualified deferred compensation plans:

- 1.) all of the contributions/premiums are deductible to the sponsoring company (contributions to non-qualified deferred compensation are NOT deductible); and
- 2.) only 65% of those premiums/contributions are includible in the income of the participating owner/key executive.

EXECUTIVE BENEFITS

Most medium to large companies have group life programs and can superimpose a **SELECT 79** plan for owners and key executives. Again, the principle benefit to the participant is that they only have to include approximately 65% of the premiums/contributions in their income.

As previously stated, only companies who file as “C” corporations can provide these benefits and deduct the premiums/contributions for owners and key executives. However, related entities that file as a “C” corporation can be established and Section 79 benefits can be made available for those who desire participation in a plan.

ESTATE TAX AND LIQUIDITY PLANNING

Another benefit is that a **SELECT 79** participant is permitted to irrevocably assign their coverage the proceeds can be kept out of their estate.

In essence, the cost of the insurance used for this purpose is discounted by about 35%--the portion that the participant does not have to include in income.

IMPORTANT MARKETING NOTE

1.79-1 of the Regulations states that “an employee may elect to waive or drop permanent benefits” (see yellow box above under “The Concept”).

As such, participation in our “79” program is not mandatory meaning that only one member of a key group of executives or professionals may elect participate and the other eligible candidates can waive out.

Furthermore, there is no level of participation formula that everyone has to adhere or be forced into if they want to participate in a “79” program.

We have several “79” plans in place for physician groups where only a few of the eligible doctors have elected to participate, and those who have done so have elected different premium/contribution levels based on their economic circumstances. The same would obviously be true in the senior executive or key employee markets.

SELECT 79 PRODUCT VALUES

Male age 45

Design to achieve 35% deduction

Credited Rate = 4.75% for 5 years, 7.25% thereafter (using an equity index crediting strategy)

Year	Total Contribution	Employee Portion (Taxable)	Employer Portion (Non-Taxable)	Loan	AV	SV Net of Loans	DB Net of Loans
1	100,000	65,000	35,000	0	67,006	15,076	1,731,003
2	100,000	65,000	35,000	0	136,033	89,296	1,731,003
3	100,000	65,000	35,000	0	207,094	167,281	1,731,003
4	100,000	65,000	35,000	0	280,190	245,570	1,731,003
5	100,000	65,000	35,000	0	355,320	327,624	1,731,003
6	0	0	0	0	378,763	356,260	1,731,003
7	0	0	0	0	403,736	388,157	1,731,003
8	0	0	0	0	430,342	419,956	1,731,003
9	0	0	0	0	458,669	453,476	1,731,003
10	0	0	0	0	488,794	488,794	1,731,003
11	0	0	0	0	520,748	520,748	1,731,003
12	0	0	0	0	554,609	554,609	1,731,003
13	0	0	0	0	592,400	592,400	1,211,702
14	0	0	0	0	632,750	632,750	1,211,702
15	0	0	0	0	675,886	675,886	1,211,702
16	0	0	0	0	721,898	721,898	1,211,702
17	0	0	0	0	771,231	771,231	1,211,702
18	0	0	0	0	824,185	824,185	1,211,702
19	0	0	0	0	881,105	881,105	1,211,702
20	0	0	0	0	942,375	942,375	1,211,702
21	0	0	0	77,000	925,812	925,812	1,130,082
22	0	0	0	77,000	908,223	908,223	1,112,731
23	0	0	0	77,000	889,108	889,108	1,095,920
24	0	0	0	77,000	868,322	868,322	1,076,636
25	0	0	0	77,000	845,726	845,726	1,054,658
26	0	0	0	77,000	821,178	821,178	1,029,753
27	0	0	0	77,000	794,772	794,772	987,156
28	0	0	0	77,000	766,458	766,458	939,630
29	0	0	0	77,000	736,200	736,200	886,871
30	0	0	0	77,000	703,991	703,991	828,577
31	0	0	0	77,000	669,735	669,735	764,321
32	0	0	0	77,000	632,560	632,560	733,034
33	0	0	0	77,000	592,204	592,204	698,872
34	0	0	0	77,000	548,385	548,385	661,566
35	0	0	0	77,000	500,378	500,378	620,386
36	0	0	0	77,000	447,181	447,181	574,310
37	0	0	0	77,000	388,254	388,254	522,803

Year	Total Contribution	Employee Portion (Taxable)	Employer Portion (Non-Taxable)	Loan	AV	SV Net of Loans	DB Net of Loans
38	0	0	0	77,000	322,987	322,987	465,263
39	0	0	0	77,000	250,708	250,708	401,018
40	0	0	0	77,000	170,687	170,687	329,343
41	0	0	0	0	165,822	165,822	333,242
42	0	0	0	0	158,916	158,916	335,539
43	0	0	0	0	149,787	149,787	336,074
44	0	0	0	0	138,268	138,268	334,707
45	0	0	0	0	124,218	124,218	331,326
46	0	0	0	0	107,495	107,495	325,820
47	0	0	0	0	92,134	92,134	276,402
48	0	0	0	0	79,038	79,038	224,972
49	0	0	0	0	69,219	69,219	172,055
50	0	0	0	0	63,922	63,922	118,330
51	0	0	0	0	63,083	63,083	63,083
52	0	0	0	0	62,140	62,140	62,140
53	0	0	0	0	61,085	61,085	61,085
54	0	0	0	0	59,934	59,934	59,934
55	0	0	0	0	58,686	58,686	58,686