

# *Retirement Planning for Executives & Business Owners*

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# *Two Places You Can Put Your Retirement Money*

## ❖ Non-Qualified Plan

- **After Tax Money**
- Employer Controls
  - ◆ Who is Eligible
  - ◆ When Entered
  - ◆ How Much Goes Into Plan
  - ◆ What Gets Paid
  - ◆ When Vested
- The Employer Also Wants To Be Able To
  - ◆ Reward Key Employee
  - ◆ Reward Self for Investment of Time, Money and Risk

## ❖ Qualified Plan

- **Pre - Tax Money**
  - ◆ Tax-Deduction for Er
  - ◆ No Taxable Income for Ee
- Highly Regulated
  - ◆ Who is Eligible
  - ◆ When to Enroll
  - ◆ How much to Contribute
- Rules Keep Changing





# *Qualified vs Non Qualified*

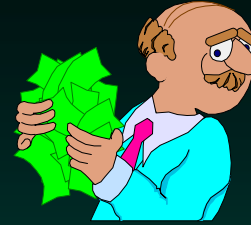
- ❖ Both Plans typically have the same investments:
  - ❖ Stocks and Bonds (Mutual Funds)
  - ❖ Life Insurance
  - ❖ Annuities



## *Qualified Plans*

- ❖ Qualified plans “qualify” for a tax deduction by using a shell:
  - ❖ 401-K Plan, Profit Sharing Plan, Money Purchase Plan etc.

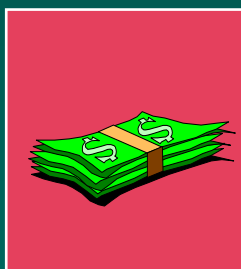
# Qualified Plans



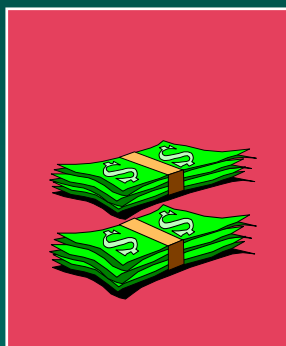
- ❖ But, Let's Look at Those Tax Deductions From Another Perspective:

# Qualified vs. Non-Qualified Plans

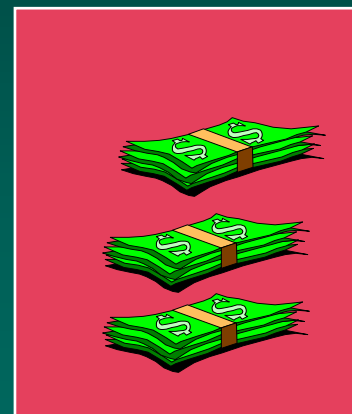
- ❖ Assume you own three boxes full of money. Which box do you want to pay taxes on?



Small



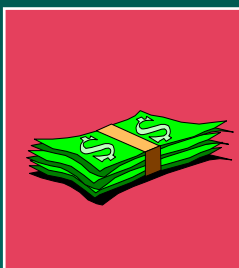
Medium



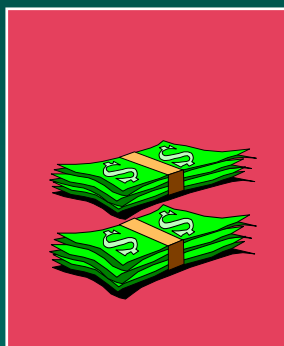
Large

# Qualified vs. Non-Qualified Plans

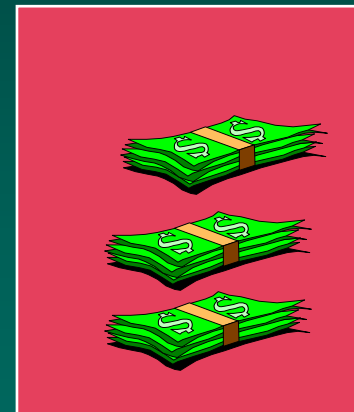
- ❖ If you choose the large box you'll be taxed forever with the largest tax.



Small



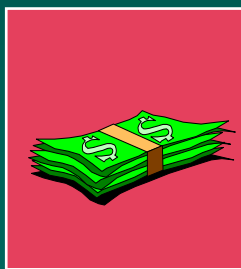
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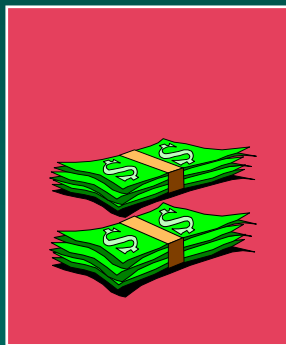
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# Qualified vs. Non-Qualified Plans

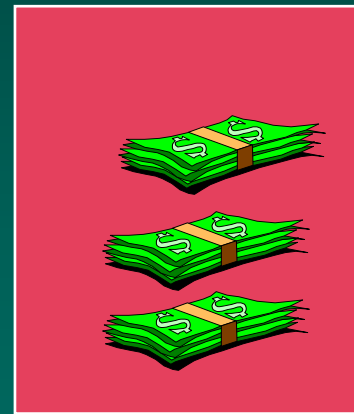
- ❖ If you choose the small box your taxes are limited with the smallest total tax.



Small



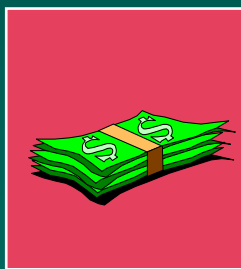
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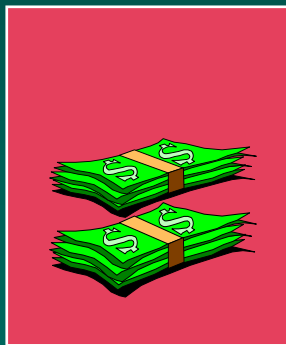
Large

# Qualified vs. Non-Qualified Plans

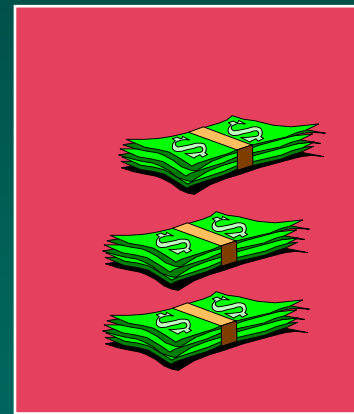
- ❖ The small box of course, but if you own a qualified plan you are actually paying taxes on the large box.



Small



Medium



Large

# *Within Your Qualified Plan...*

- ❖ The Original Idea Was to Defer to Pay Taxes When We Are In A Lower Tax Bracket at Retirement
  - For the Rank & File, that may still be true
  - But for most executives and business owners, your tax bracket actually **INCREASES** at retirement!



# Qualified Plans

- ❖ The boxes represent the three phases of your qualified plan and . . .
- ❖ With any qualified plan you have a partner . . . Uncle Sam.



Contribution



Accumulation



Benefit



## *Qualified Plans*

- ❖ Uncle Sam is going to tell you who must be in the plan.
- ❖ He's also going to tell you how much you can put into the plan.



## *Qualified Plans*

- ❖ As a business owner the maximum you can put into a qualified plan is \$30,000.
  - (25% of income or \$30,000 which ever is less).
  - Qualified Plans: (e.g.. Profit Sharing, Money Purchase, Pension ).



## *Qualified Plans*

- ❖ If you put in \$30,000 for yourself, you will need to match \$15,000 to \$20,000 for employees.
- ❖ Matching contributions must be vested in 5 to 8 years.



## Qualified Plans

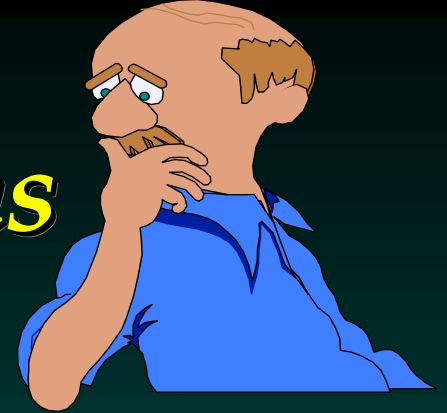
- ❖ Uncle Sam also tells you when you can withdraw the money from plan.
  - Withdraw prior to 59 1/2: 10% federal tax, plus some states charge a penalty tax.
  - At age 70 1/2, must withdraw minimum distributions. If not: 50% tax.



## Qualified Plans

- ❖ You will also have administration costs that range between \$300 and \$8,000 per year.
- ❖ About every 2-3 years Uncle Sam changes the rules, which usually costs you money.

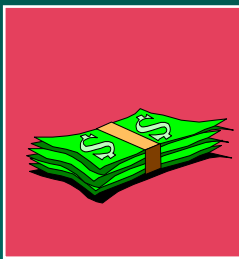
# History of Qualified Plans



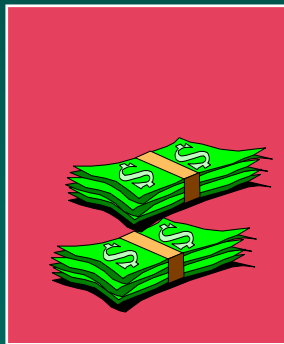
- 1974 - ERISA ( Employee Retirement Income Security Act )
- 1978 - TRA ( Tax Reform Act of 1978 )
- 1982 - TEFRA ( Tax Equity Fiscal Responsibility Act )
- 1984 - DEFRA ( Deficit Reduction Act )
- 1984 - REA ( Retirement Equity Act )
- 1986 - TRA 86 ( Tax Reform Act of '86 )
- 1987 - OBRA ( Omnibus Budget Reconciliation Act )
- 1989 - Phase In Provisions of '86 Act Completed
- 1993 - Tax Reform Act of '93 (Clinton Revenue Action Plan - **CRAP**)
- 1995 - GATT
- 1997 - Taxpayer Relief Act of '97

# Qualified Plans

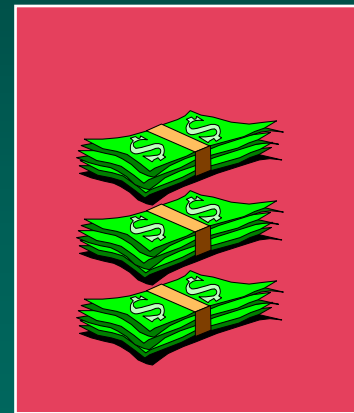
- ❖ If you don't do all these things correctly you have the potential of being audited which costs you additional time and money.



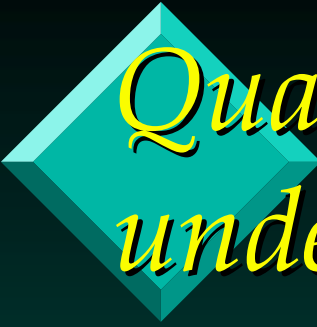
Contribution



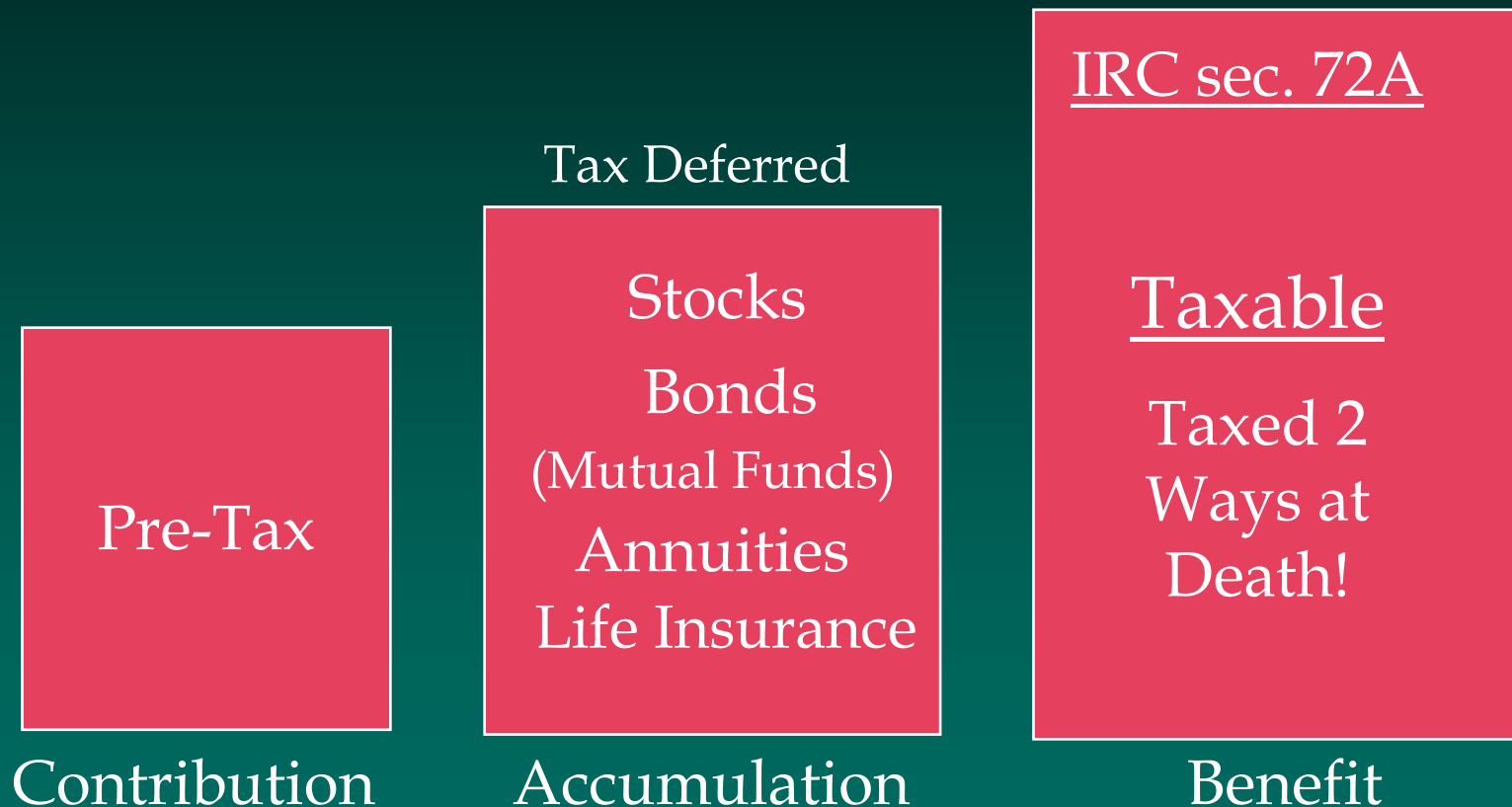
Accumulation



Benefit



*Qualified Plans are governed  
under IRS code section 72a*





# *Qualified Plans: Double Taxation at Death*

- ❖ Income Tax (Federal and State)
- ❖ Estate Tax (as high as 55%)
- ❖ Your family could lose between 65%-75% of what is in the plan.

# Code section 72a affects the way you get your retirement benefits

- \$30K for 20 Yrs at 8% = \$1.5 Million\*
- Withdraw 8%/year = \$120,000\*\*
- \$120,000 x 30% Tax = \$36,000 Tax Bill.

Pre-Tax

Contribution

Stocks  
Bonds  
(Mutual Funds)  
Annuities  
Life Insurance

Accumulation

## Qualified Plan

IRC sec. 72A

**LIFO**  
Taxation

\$1.5 Million  
Nest Egg

Benefit

\*Approximation

\*\*Taxable Retirement Income



## *Qualified Plans*

- ❖ How long will it take Uncle Sam to recapture your qualified plan tax savings?
  - \$30,000 contribution x 20 years = \$600,000
  - x 30% tax bracket = \$180,000 (Tax Savings)
  - \$120,000 withdrawal x 30% tax bracket =
  - \$36,000 in taxes per year (LIFO).
- ❖ Tax savings recaptured in just over 5 years!  
(\$36,000 tax bill x 5 years = \$180,000 in taxes)



## *Qualified Plans*

- ❖ If you live the 20 years the IRS mortality tables say you will, you'll end up paying **\$800,000** in taxes. (20 years x \$36,000 annual tax bill)
- ❖ That's more than the **\$600,000** you originally put into the plan !



*The way to pay taxes on the small  
box:*

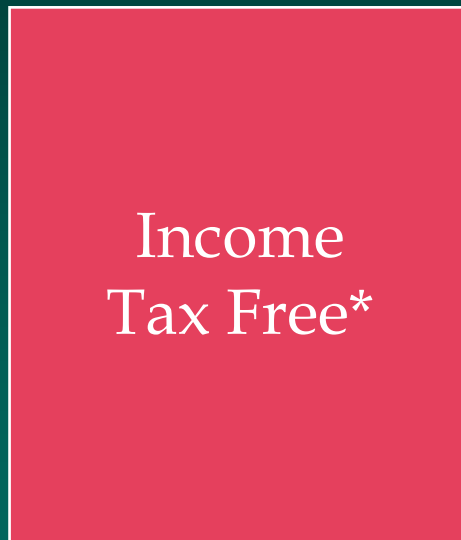
- ❖ **Non Qualified Plans**
  - **Life Insurance**

# Non-Qualified Plans: Life Insurance

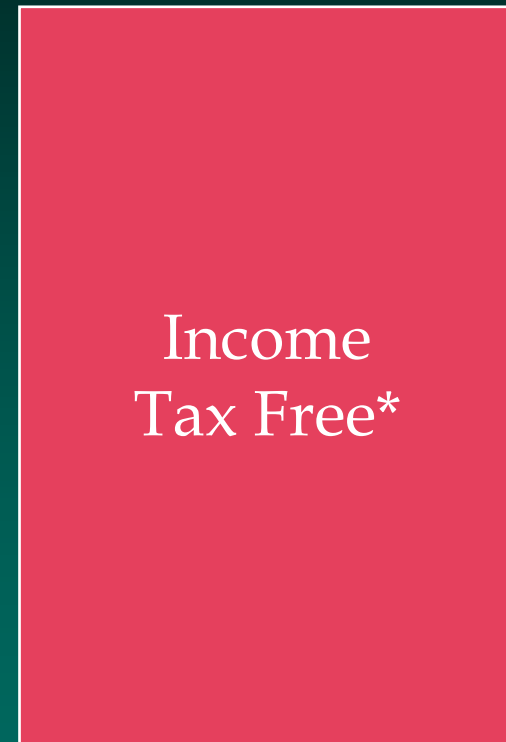
❖ Same 3 boxes



Contribution

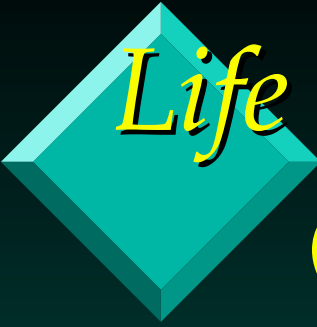


Accumulation



Benefit

\*Life Insurance accum. values, withdraws, loans and death benefits can be tax free



# *Life Insurance = No Partner*

## *(No Uncle Sam)*

- ❖ No rules on who must participate
- ❖ No contribution limits (how much)
- ❖ No Early Withdrawal Penalties (when)
- ❖ No matching requirements
- ❖ No vesting requirements
- ❖ No administrative costs
- ❖ No changes every 2 or 3 years
- ❖ No potential audits



# *Non-Qualified Plans: Life Insurance*

- ❖ The code section has changed to 101a, which states that when you die your death benefit is income tax free.
- ❖ **Your family won't lose 65%-75%**
  - What's the value of \$1,000,000 tax free?
  - \$1,428,571 taxable (assuming a 30% tax bracket)



# *Life Insurance: 101a Plan*

❖ FIFO accounting

VUL

after-tax \$

Contribution

Stocks

Bonds

(Mutual Funds)

Annuities

Life Insurance

Accumulation

FIFO (not LIFO)

IRC sec. 101a

Income Tax  
Free at Death

**FIFO** Taxation

Zero-Cost  
Loans

Benefit



# *Non-Qualified Plans: Life Insurance and FIFO accounting*

- ❖ **Best case scenario is zero cost**
  - (zero cost loans guaranteed, charge 6% credit 6%).
- ❖ **Worse case scenario is 2% net cost**
  - (we charge 8% credit 6% on loans)
- ❖ **Withdraw the same 8% on the \$1,500,00 from your life insurance policy tax free.**



# *Qualified vs Non Qualified Plans:*

- ❖ What would you rather do, pay a 2% charge on your retirement income or a 30% tax?
- ❖ The choice is yours



## *Non-Qualified Plans: Life Insurance*

- ❖ In order to contribute \$30,000 into a life insurance policy, you need need to make about \$43,000 pre-tax (assuming a 30% tax bracket).
- ❖ Isn't it better to pay taxes now, while we are in a relatively low tax bracket



# HISTORY OF U.S. FEDERAL INCOME TAX RATES



YEARS	Range of Rates (%)	Taxable-income brackets*	
		Lowest: amount under	Highest: amount over
1913-1915	1 - 7	\$20,000	\$500,000
1923	3 - 56	4,000	200,000
1932-1933	4 - 63	4,000	1,000,000
1942-1943	19 - 88	2,000	200,000
1954-1963	20 - 91	2,000	200,000
1972-1976	14 - 70	500	100,000
1983	0 - 50	3,400	109,400
1996-1999	<u>15 - 39.6</u>	43,050	283,150

**Average Tax Bracket 56.72%**

\*Married, filing jointly

# Reasons for Non-Qualified Plans

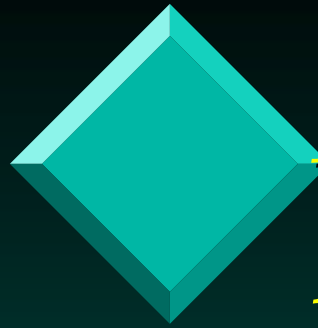
## ➤ THE EMPLOYER WANTS:

- To control WHO goes into the plan
- To control WHEN the employee goes into the plan
- To control HOW MUCH goes into the plan for each individual employee
- To control WHAT the employee receives if he terminates
- To control WHEN the employee vest in the plan



## ➤ THE EMPLOYER WANTS:

- To be able to REWARD employees based upon their value to the business
- To be able to REWARD themselves commensurate with their investment in time, money and risk



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