

## Life Insurance and SEP-IRAs

# It's As Easy As 1-2-3!



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## A Complex Question

This time of year, we often receive calls regarding clients who have missed the calendar-year new plan installation deadline of 12/31. They desire deductible contributions for the prior year, and perhaps the acquisition of tax-favored life insurance within a plan.

Unfortunately, the code does not allow plan documents to be backdated, since with all trusts, the Pension Trust must exist before it is deemed to have *corpus*. Thus, the plan documents must be executed prior to any New Year's Eve celebration for those calendar-year taxpayers who are looking to enjoy a new tax-qualified retirement program.

The operative question, then, is what *can* they do?

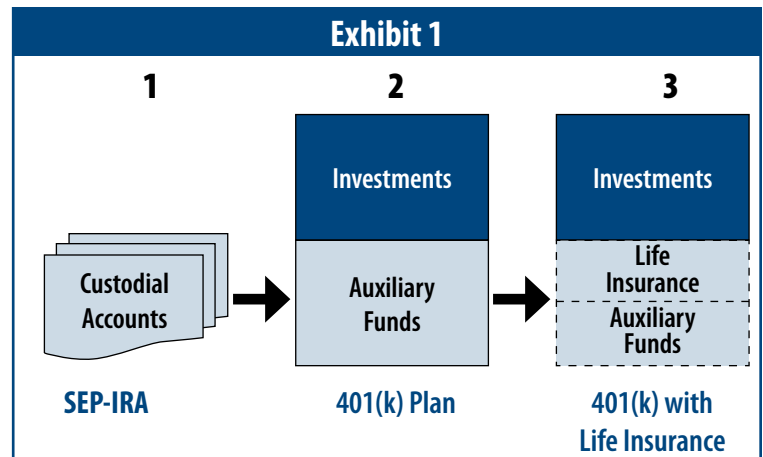
## A Simple Answer

The answer is *simple*, as in Simplified Employee Pension (SEP). Despite its name, a SEP is not actually

a pension plan. Rather, it is a special type of Individual Retirement Account (IRA). To avoid confusion, many professionals will refer to it as a SEP-IRA.

Unlike a pension plan, IRAs may be established by the client's tax-filing date (including extensions). Thus, a sole proprietor who missed the 12/31 deadline but wants to start a program for the prior tax year may create a SEP-IRA by April 15 (or perhaps as late as October 15 if on valid extension).

This may be welcome news, but IRAs can't include life insurance, right? Well, yeah—they can't include life insurance. Fortunately, the 2001 Act radically changed the portability rules for qualified monies making it easy for a SEP-IRA to be rolled into a new retirement plan, perhaps a Micro(k)<sup>®</sup>. A pension plan or Micro(k) may include life insurance as a permitted investment. Better yet, SAI's prototype deems all IRA rollovers to 401(k) and profit sharing plans to be "aged money" that can be used without limitation to meet the life insurance needs of the participant. That may be welcome news to all!



## SEP-IRA Basics

### Contributions

In this very simple design, the business owner(s) may contribute up to 25 percent of pay for every eligible employee in any given year. Thus, if an S Corporation owner has a W2 wage of \$100,000, he or she may contribute \$25,000 into a SEP-IRA.

Non-incorporated enterprises (e.g. LLCs and sole proprietors) may use a SEP-IRA as well. However, the contribution is limited to 25 percent of the *net* earned income. For example, for a sole proprietor to contribute \$25,000, he or she would need a net profit of \$125,000 after payroll taxes are paid. Although this calculation may be somewhat complex, the client's CPA and most tax-software programs can perform this each year.

### Eligibility

Initially, one of the most appealing aspects of a SEP-IRA is the definition of eligibility. Unlike a 401(k) plan where a "one-year wait" is the maximum, employees may not enter a SEP-IRA until they have had at least three years of service in the preceding five year period.

Unfortunately, an employee needs to earn only \$500 (indexed) in any year to satisfy the eligibility requirement. This means that if a business has seasonal employees who return each year (e.g. students, landscapers, construction workers, etc.) these employees will be eligible for the SEP contribution following their third year of service and must also receive the same, non-integrated, 0–25 percent of pay contribution that the owner receives.

Thus, a SEP-IRA makes an excellent “starter” plan and is often used when there are no eligible employees. However, once a single common-law employee becomes eligible to participate, a SEP-IRA may be among the most “expensive” plans to operate, when employee benefit cost is considered.

## Investments

An IRA is restricted in the types of investments available, since all investments must be held in a custodial account. As mentioned previously, life insurance is *not* a permissible investment. Security Mutual Life offers two- and five-year custodial accounts which are ideal for funding SEP-IRAs. You can download information on these very easy-to-use funding agreements from Librarian on SecurityLink.

## Easy As 1–2–3

Now that we have reviewed the pros and cons of the SEP-IRA, let’s return to our simple sales strategy made possible by the 2001 Act. It’s as easy as 1–2–3:

1. Establish a SEP-IRA for the prior tax year using our two- or five-year IRA custodial accounts.
2. Establish a Micro(k) or profit sharing plan and roll over the custodial accounts by mapping them into our two- or five-year auxiliary funds.
3. Make penalty-free withdrawals of auxiliary funds money to pay associated SML life insurance premium.

Some clients will do Step 1 only, and if a SEP-IRA is suitable, that’s fine. However, a SEP-IRA does not have the many features of a modern retirement plan (e.g. loan provisions, salary deferrals and catch-ups beyond age 50). A Micro(k) or other qualified retirement plan may be more beneficial in the long run and much less costly should employees enter the plan.

Thus, many of your clients will pursue Step 2 right away. However, for those clients who need life insurance and like the affordability of using pre-tax dollars that already reside within the plan, Step 3 can be compelling. Let’s examine each of these steps in greater detail.

### Step 1

Establishing a SEP-IRA is easy. The “Plan Document” is IRS form 5305-SEP which is packaged as part of our new SEP-IRA sales kit on the Defined Contribution section of [www.SMLplans.com](http://www.SMLplans.com). Your client may select either our two-year or five-year custodial account agreement or split monies between both. Each custodial account agreement is bundled with IRS form 5305-A (IRA). Send the completed package to our Funds Unit at the Home Office. That’s it!

### Step 2

A suitable retirement plan can be designed with support from the Marketing Department and installation by SAI. Just complete a Fact Finder and let us know the goals and budget. Each participant may elect to roll over his or her custodial account into an auxiliary fund. For example, a two-year custodial account agreement will be mapped to our two-year auxiliary fund, and the five-year custodial account will map to our five-year auxiliary fund.

### Step 3

Our auxiliary funds contain a very special feature that allows the trustee to transfer monies to pay for “associated Security Mutual Life Insurance premium” which will be fully commissionable as new business.

When combined with the “aged money” provisions of SAI’s 401(k) and profit sharing prototype documents, this “turn-key” solution unlocks powerful planning opportunities.

That’s because IRA rollovers may be used without limits to purchase life insurance on the life of the participant, the participant and spouse (e.g. Survivorship UL) or on anyone in whom the participant has an insurable interest.

The new retirement plan may benefit from a broad array of suitable investments selected by the trustee. SAI can administer nearly any investment election that can be valued annually.

## Conclusion

Although backdating documents to prior tax years is not permitted, many of your clients who need a program may turn to the economical SEP-IRA. Our new sales kit makes it easy to install and fund a plan with our products.

A *bona fide* retirement plan may be established in the current tax year that may offer many more advantages, including offering life insurance as an investment choice.

We make it easy to roll over custodial accounts into our guaranteed interest auxiliary funds which allow ready access to pay life insurance premium with us. It’s as easy as 1-2-3! Let us know how we can help you.



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