National Life Group®

A Guide to Life Insurance in Qualified Plans

Products issued by:

National Life Insurance Company | Life Insurance Company of the Southwest

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A Guide to Life Insurance in Qualified Plans

This Guide is intended to help you learn how to select the most appropriate type of qualified plan and the most appropriate type of insurance within that plan to meet clients' goals.

Clients' goals and objectives always come first. Proper fact finding and suitability are essential in designing the most appropriate plan for the client. However, no plan is static and plans must be monitored from year to year to ensure that the plan that was initially implemented is still appropriate. As the clients' financial needs change over time, so do the planning opportunities.

As this guide does not cover every situation you will encounter, please know we are here to provide you with the expert direction you and your clients deserve. We are just a phone call away from you, your client and/or your client's other professional advisors. We are here to personally assist you in the sales process.

Qualified plans are offered and administered independently of the companies of National Life Group. National Life is bound only by the terms of the life insurance contracts issued by the Group insurance companies.

The companies of National Life Group® and their representatives do not offer tax or legal advice. Please encourage your clients to seek tax or legal advice from their appropriate professional advisor.

Table of Contents

Qualified Plans

Determining where your client is in his or her business/personal life is a starting point for designing a retirement plan. The plan will be designed based on the client's goals, objectives and budget, and life insurance can be included in the plan to help meet these objectives.

You must remember that this is a process. Once a plan is designed it must be monitored on an annual basis to evaluate that the plan continues meeting the owner's business and personal objectives.

Questions to Ask the Business Owner

Eligibility

- Who is the plan designed for?
- Will there be any service requirements?
- Will there be an age requirement?
- Does the owner wish to exclude employees by job category?

Goals and Objectives

- Is there a specific retirement income goal?
- Is there a specific contribution goal?
- Is a guaranteed benefit important?
- How important is flexibility of contributions?
- Is there anyone the business owner wants to favor?

Offering an Employee Benefit

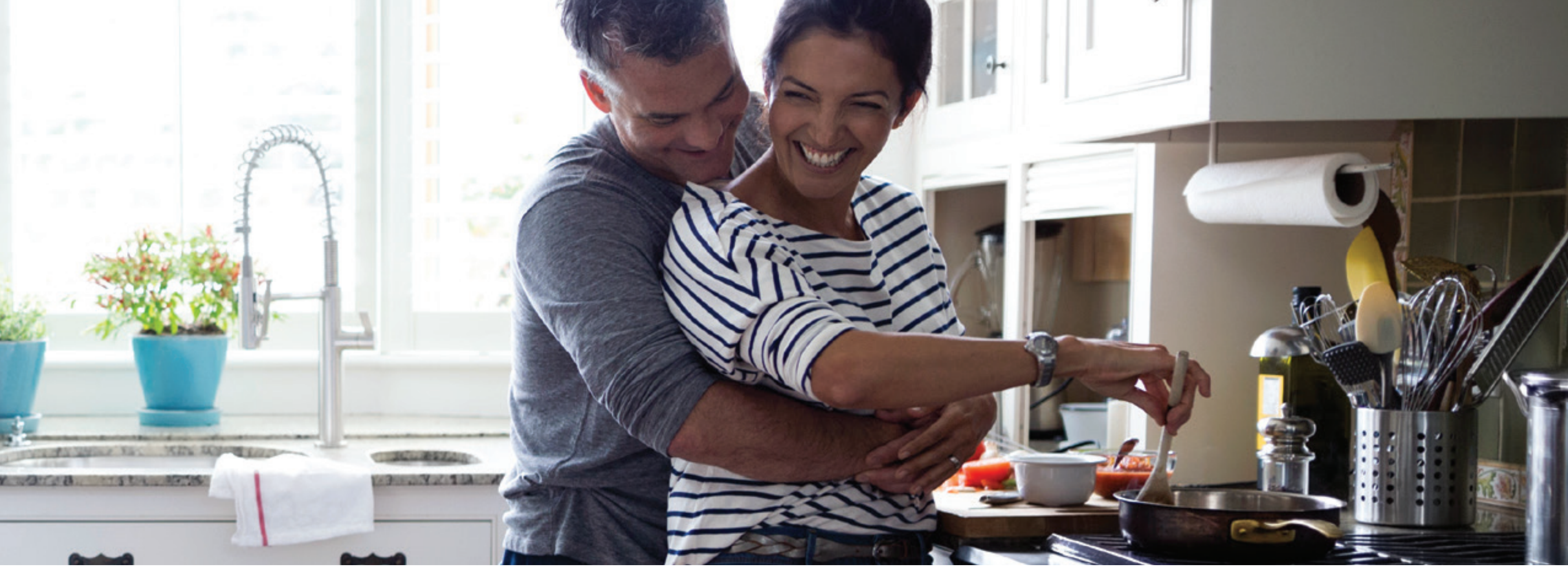
- Does the employer wish to institute a vesting schedule for his/her contributions?
- Will employees be provided the opportunity to make salary deferrals?
- Will employees have access to their funds prior to retirement?

Investments

- Will employees direct their own investments?
- How comfortable is the business owner with market risk?
- Are there life insurance needs?
- Is there life insurance now in force that is being paid for with after-tax personal dollars?
- Would the business owner like to have their life insurance needs paid for with business dollars?

Other Business Relationships

- Does the employer want to include or exclude employees from other business ventures?



Life Insurance in Qualified Plans

In keeping with sound planning, planners must first identify issues and goals of business owners. Then develop the most efficient means to achieve them. Significant planning issues for business owners encompass:

- Accumulation planning
- Protection planning
- Estate preservation, and
- Tax efficiency

The following information focuses on accumulation planning and tax efficiency with qualified plans and protection planning with life insurance.

For specific plan design and production information you may rely on Advanced Markets to complement your team. Advanced Markets can be reached at **800-906-3310** or **qpm@nationallife.com**.

Why Use Life Insurance in a Qualified Plan?

A few key reasons include:

- The life insurance premium is part of the deductible employer contributions made to the qualified plan.
- The employer contribution is made pre-tax, so the life insurance premium is paid using pre-tax dollars, thus freeing up personal dollars. If the same life insurance premium were paid outside of the qualified plan, it would be paid using after-tax dollars so more money would have to be earned to net the premium amount, after taxes.
- At the time of death, the beneficiary would receive the current value in the plan account and the death benefit from the life insurance.
- Life insurance in a qualified plan is issued with the plan trust as owner and beneficiary. The plan participant will be the insured. At retirement, the insurance policy can be transferred to the participant as part of their retirement distribution.
- If the participant's life insurance need has changed at retirement, the life insurance policy can be surrendered inside of the plan and the policy cash value added to their fund account.
- The small tax paid annually on the "economic benefit" provided by the policy in the plan may be recovered income tax-free at retirement.
- Life insurance in a defined benefit plan increases the contribution and deduction.

Life Insurance Incidental Limits

A qualified retirement plan (other than a SEP-IRA, SIMPLE-IRA, 403(b) or SAR-SEP) may purchase life insurance on the lives of the plan's participants. In order to include life insurance, the plan document must include language that allows for the purchase of insurance, and the life insurance benefit must be incidental to the main purpose of the plan, which is to provide for retirement benefits. There are several tests to utilize in making the determination that the life insurance is incidental.

Defined Contribution Plans

Percentage of the plan contributions:

- If whole life insurance is used, up to 49.9% of the plan contribution may be used for the life insurance premium.
- If universal or variable universal life insurance is used, up to 25% of the plan contribution may be used for the life insurance premium.

This test is a cumulative test, applied to cumulative contributions and premiums over the life of the plan.

Profit Sharing Plans Special Rules

Profit Sharing plans do include an exception to the incidental benefit rules for the life insurance. If a profit sharing plan has "seasoned money" it may allow for the use of 100% of the seasoned money to be used toward the life insurance premium.

- Two-Year Seasoned Money Rule: If the Trust has funds (contributions and earnings) that have been accumulated for at least two years, 100% of those funds may be used towards premiums.
- Five-Year Seasoned Money Rule: Once someone has been a plan participant for more than 5 years, the incidental limits no longer apply and all funds may be used to pay life premiums.
- Rollover Rule: If a participant has money that was from a previous plan or IRA and rolled it into the qualified plan, 100% of those funds may be used toward the life premiums.
- Employee voluntary, after-tax, non-Roth contributions may be used to purchase life insurance in excess of the incidental limits.
- ESOPs that are not funded with an exempt loan may purchase life insurance in excess of the incidental limits.

Defined Benefit Plans

Testing whether life insurance benefits are incidental can be done by one of two methods:

- Percentage of contributions: Revenue Ruling 74-307 permits up to two-thirds of the theoretical contribution to be used for whole life insurance premiums, or one-third for universal life insurance premiums. An actuary will calculate the equivalent contributions used to fund the participant's benefit and compare those contributions to the premium.
- 100-Times Method: The life insurance benefit provided, without regard to premium, cannot be more than 100 times the anticipated monthly annuity benefit.

Taxation of Life Insurance in a Qualified Plan

When life insurance is provided in a qualified plan there is a current taxable event to the participant known as the "economic benefit." This is usually the Table 2017 cost (previously known as the P.S. 58 cost) or an alternative rate (the lower of the insurer term rates applicable to all insureds) that is generally available. The theory of the income taxation of the "economic benefit" is that the participant is currently receiving a benefit (the life insurance protection) under the plan and a current benefit should be taxed as opposed to a future benefit which is deferred.

CSO Table 2017 Cost

Using the Table 2017 term rate, a 50 year old male would pay an economic benefit of $1.55 per $1,000 of coverage.

Age	Death Benefit	Cash Value	Net Insurance Amount	Taxable Economic Benefit	Tax paid by Participant (40%)
50	$500,000	$31,563	$468,437	$725 (468 x $1.55)	$290

Lower Cost with National Life ART Rates

Using the same example, and using National Life's term rate, a 50 year old would pay an economic benefit of $0.75 per $1,000 of coverage.[1]

Age	Death Benefit	Cash Value	Net Insurance Amount	Taxable Economic Benefit	Tax Paid by Participant (40%)
50	$500,000	$31,563	$468,437	$351 (468 x $0.75)	$140

Income-Tax Free Death Benefit

Should the insured die before retirement with the life insurance held in the plan, the beneficiary would receive the net death benefit as an income-tax free death benefit. The cash surrender value is taxed to the beneficiary in the same manner as any other distribution from the plan. The taxable term cost that has been paid may be applied as basis to the taxable amount.

Using the previous example, below is a breakdown of the taxable and tax-free benefits that would be paid to the plan participant's named beneficiary, if the participant died at age 60:

Face Amount of Life Insurance	$500,000
Fair Market Value prior to death	143,336
Income-Tax Free Death Proceeds[2]	356,664
Amount Previously Taxed to Insured[3]	5,441
Total Amount Excluded From Income	$362,105
Side Fund Account Value[4]	

1 This example is purely hypothetical and for illustrative purposes only. The examples shown above do not represent the actual results of any particular plan and your clients results likely will differ.

2 Internal Revenue Code 101(a)(1). There are some exceptions to this rule. Please consult a qualified tax professional for advice concerning your individual situation.

3 This is the total of the National Life's ART rates that the individual has paid since he/she has been in the plan (from age 45 through 60 assuming the rates remain constant). (Estimate of the sum of all the years' economic benefit costs.)

4 Whatever value is in the plan's side fund account can be rolled to an IRA by the beneficiary. Taxes will be deferred until such time as the beneficiary takes distributions from the IRA account.

Life Insurance Products Suited for Qualified Plans

Once the decision has been made that life insurance is appropriate for the plan, the next step is determining which product is most appropriate for the plan chosen. There is no exact method to match products with plans but information on the various products might help you through the selection process. Note that IRA plans (403(b), SEP-IRA, SIMPLE-IRA and SARSEP) cannot include life insurance.

Whole Life Products

- **TotalSecure** whole life is for consumers who want survivor protection and premium dependability. It can be designed to provide a high death benefit for premium dollar, or to build up significant policy cash value. TotalSecure also offers premium flexibility that generally is only available with universal life policies.
- TotalSecure can be used in all ERISA qualified plans.

Universal Life Products

- **FlexLife and PeakLife** indexed universal life offers flexibility with Interest Crediting Strategies based on changes in the S&P 500® and several other indexes.[5] With FlexLife and PeakLife IUL the policyholder has both premium and death benefit flexibility.
- The Balance Sheet Benefit rider for FlexLife and PeakLife IUL can be used to provide high guaranteed cash value from year one. The BSB rider eliminates all surrender charges on the units of insurance to which it applies. There will be a monthly charge based on issue age, sex and rate class per unit of coverage for the rider.[6]

Term Insurance

While term insurance is an appropriate solution for individuals seeking the largest amount of death benefit at the lowest premium, term insurance may not be appropriate in the qualified plan environment.

There is no tax efficiency when using term insurance in qualified plans. The reportable economic benefit to the participant is the actual premium, whereas with permanent insurance, the reportable economic benefit to the participant is an amount that is substantially less than the actual premium.

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5 "Standard and Poor's®," "S&P®," "Standard and Poor's 500," and "500" are trademarks of Standard & Poor's and have been licensed for use by Life Insurance Company of the Southwest. The product is not sponsored, endorsed, sold or promoted by S&P and S&P makes no representation regarding the advisability of investing in this product. The S&P Composite Index of 500 stocks (S&P 500®) is a group of unmanaged securities widely regarded by investors to be representative of large-company stocks in general. An investment cannot be made directly into an index.

6 Products and Riders may not be available in all states. This rider is optional and available at an extra cost. Not available in all states.

Life Insurance Product and Rider Availability in Qualified Plans

Not all life insurance products are available for use in qualified plans and not all product riders can be used. The plan type will determine what life products are available as well as riders that may be included. For example, the Fully Insured Defined Benefit 412(e)(3) Plan must be funded with life insurance company products that have guarantees. Therefore, only one whole life product, TotalSecure, can be used in 412(e)(3) Plans. Additionally, in all defined benefit plans, only riders that do not add a cost can be included. Riders such as the Qualified Plan Exchange Privilege (QPEP) Rider and the Lifetime Income Benefit Rider (LIBR) can be added at issue because there is no additional charge associated with adding these riders to the life insurance policy. There could be fees in the future, if the riders are exercised. But because the riders could not be exercised while the insurance is in the plan trust, the riders are available.

While it may be possible to include riders in the life insurance policy issued in the plan, the riders could not be utilized until the plan participant removed the insurance from the plan. While the life insurance is in the plan it is owned by the plan trust, not the individual participant.

KEY

- = All Plan Types
- = Profit Sharing Only
- = Profit Sharing/401(k) Only
- = Existing Plan with WP
- = Not 412e3
- = Not Available

RIDERS	TotalSecure WL	FlexLife IUL	PeakLife IUL
Accelerated Benefit Rider Critical Illness*	Profit Sharing Only	Profit Sharing Only	Profit Sharing Only
Accelerated Benefit Rider Critical Injury	Profit Sharing Only	Profit Sharing Only	Profit Sharing Only
Accelerated Benefit Rider Terminal Illness*	All Plan Types	All Plan Types	All Plan Types
Accelerated Benefit Rider Chronic Illness*	All Plan Types	All Plan Types	All Plan Types
Accidental Death Benefit Rider (ADB)	Profit Sharing Only	Profit Sharing Only	Profit Sharing Only
Qualified Plan Exchange Privilege Rider (QPEP)	All Plan Types	All Plan Types	All Plan Types
Beneficiary Insurance Option (BIO)	Profit Sharing Only	Not Available	Not Available
Flex Term	Not 412e3	Not Available	Not Available
NL Term Riders	Not 412e3	Not Available	Not Available
Waiver of Planned Premium Rider (WP)	Profit Sharing Only	Not Available	Not Available
Annual Premium Additions Rider (APAR)	Not 412e3	Not Available	Not Available
Single Premium Adds Rider (SPAR)*	All Plan Types	Not Available	Not Available
Additional Protection Benefit Rider (APB)	Not Available	All Plan Types	All Plan Types
Balance Sheet Benefit Rider (BSB)	Not Available	Profit Sharing/401(k) Only	Profit Sharing/401(k) Only
Death Benefit Protection Rider (DBPR)	Not Available	All Plan Types	All Plan Types
Lifetime Income Benefit Rider (LIBR)	Not Available	All Plan Types	All Plan Types
Other Insured Rider (OIR)	Not Available	Profit Sharing Only	Profit Sharing Only
Interest Crediting Strategies Rider (ICSR)	Not Available	All Plan Types	All Plan Types
Systematic Allocation Rider (SAR)	Not Available	All Plan Types	All Plan Types
Waiver of Monthly Deductions Rider (WMD)	Not Available	Profit Sharing Only	Profit Sharing Only

* Limited availability for 412e3 plans.

Guaranteed and Simplified Issue for Qualified Plans

It may be possible, when offering life insurance in a qualified plan, to have insurance issued under Guaranteed Issue. To qualify for Guaranteed Issue, the plan would have to meet very specific criteria, as outlined below:

<table>
<tr><th>Maximum Age</th><th>Minimum # of Lives</th><th>Maximum Death Benefit</th><th colspan="2">Face Amount Limits (Multiple x # of Lives)</th><th>Benefit Formula</th></tr>
<tr><td rowspan="4">65
Weighted age of 55</td><td rowspan="4">10
5 by exception</td><td rowspan="4">Subject to pre-case underwriting</td><td>10-19</td><td>$35,000</td><td rowspan="4">Driven by the qualified plan
Death benefit as low as $5,000</td></tr>
<tr><td>20-29</td><td>$40,000</td></tr>
<tr><td>30-49</td><td>$45,000</td></tr>
<tr><td>50+</td><td>$50,000</td></tr>
</table>

Participation Requirements:

- Employer Sponsored:
  100% of eligible employees
- Employee Election:
  70% of eligible employees

Underwriting Requirements:

- No Fluids
- No Medical Exams
- GI Application:
  Only 3 personal questions
- Accelerated Benefits: Terminal and Chronic
  (not exercisable while the policy is in the plan)

To qualify for Simplified Issue, the plan would have to meet very specific criteria, as outlined below:

<table>
<tr><th>Maximum Age</th><th>Minimum # of Lives</th><th>Maximum Death Benefit</th><th colspan="2">Face Amount Limits (Multiple x # of Lives)</th><th>Benefit Formula</th></tr>
<tr><td rowspan="4">70</td><td rowspan="4">10
5 by exception</td><td rowspan="4">Subject to pre-case underwriting</td><td>10-19</td><td>$35,000</td><td rowspan="4">Driven by the qualified plan
Death benefit as low as $5,000</td></tr>
<tr><td>20-29</td><td>$40,000</td></tr>
<tr><td>30-49</td><td>$45,000</td></tr>
<tr><td>50+</td><td>$50,000</td></tr>
</table>

Participation Requirements:

- Owned by qualified plan
- Employee Election:
  70% of eligible employees

Underwriting Requirements:

- No Fluids
- No Medical Exams
- MIB, MVR, RX
- SI Application
- Accelerated Benefits: Terminal and Chronic
  (not exercisable while the policy is in the plan)

A Two Step Process

Step 1: Inquiry Review and Offer Letter

- Complete the GI/SI Inquiry Form
- Submit the form along with a completed census (see the inquiry form for required information) to advancedmarkets@nationallife.com
- The Advanced Markets team will work with you during the inquiry process
- Upon approval you will receive a formal offer letter

Step 2: New Business and Underwriting

- Submit Group Case # request
- Submit the completed GI or SI applications to MultiLife New Business at multilife@nationallife.com

For additional questions on MultiLife please contact:

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Ellen Lehmert, J.D.; elehmert@nationallife.com

Matt Ryan, J.D.; mryan@nationallife.com

Tracey Ullom, J.D.; tullom@nationallife.com

Or go to Advanced Markets Digital Experience at nationallife.com/Financial-Professionals-Advanced-Markets

Distribution Planning

A distribution from a retirement plan is the outcome of years of planning. In many instances, second to the value of a residence, this may be an individual's largest asset holding. Careful planning is critical to preserving the accumulated assets and minimizing taxes.

Assets in the plans side fund account could be rolled to an IRA. But if there is life insurance in the plan, the life insurance cannot be rolled to an IRA. Therefore there has to be an exit strategy for the life insurance. While this discussion may seem premature at inception of the plan, it is important for a plan participant to understand options for distributing the life insurance from the plan when the participant exits the plan. By understanding this process, you will be positioned more as a consultant to your client rather than a vendor.

Distribution Choices

Life insurance cannot continue after the normal retirement date, even if the participant decides to retire at a date beyond the normal retirement date specified in the qualified plan document. With that in mind we need to determine what will be the outcome of the life insurance contract. Depending on the client's needs at the time there are five choices that he/she will have in deciding what to do with the life insurance.

1. Surrender the Contract

The life insurance contract may be surrendered by the plan Trustee. The participant will now have the cash surrender value added to his/her other plan assets. There is no longer a death benefit.

The participant can now:

- Take the lump-sum distribution and pay tax on the entire amount;
- Directly transfer the full amount into an IRA;
- Take the lump sum minus the withholding and within 60 days transfer the full amount into an IRA;
- Leave the amount in the plan and take periodic distributions (if allowed under the terms of the plan); or
- Annuitize.

2. Distribute the contract from the plan in-kind

If the plan allows for this, the life insurance contract may be distributed intact, to the plan participant. This would be accomplished by the Trustee changing ownership of the life insurance contract from the Trust to the individual. Spousal consent must be attained prior to the distribution. The individual now has a life insurance contract that they own. With this option, there is a taxable event to the individual. He/she will be taxed on the fair market value of the contract. There is no option to defer the tax on the life insurance contract; it may not be transferred to an IRA for further tax deferral.

Example:

Face Amount of Life Insurance	$500,000
Fair Market Value prior to death	143,336
Basis (accumulated taxable term costs)	5,441
Taxable Distribution Value*	137,895
Personal Income Tax (40%)	55,158

3. Distribute the contract from the plan in-kind and convert

If the life insurance contract is distributed from the plan and within 60 days is irrevocably exchanged to a non-transferable annuity contract where no life insurance proceeds are distributable after death, there would be no taxation on the cash value. This rule also applies to any portion exchanged.

* NL FlexLife Indexed Universal Life (IUL) form series 20607/ICC19-20607(0119), standard non-smoker, unisex rates ,max 25% rule, underwritten by National Life Insurance Company, Montpelier, VT.

4. **Purchase the life insurance contract from the plan**
   The plan may sell the life insurance contract to the participant. The sale may also be made to a relative of the insured or to a trust or family partnership. The amount paid to the plan for the contract must be equal to the amount necessary to equal the fair market value of the property, the life insurance contract. If the contract is purchased for its fair market value, there will be no tax owed on the distribution. If it is determined that the life insurance contract was purchased at a bargain price, the difference would be treated as a distribution subject to taxation. The cash the participant paid for the policy is now part of their retirement benefit in the qualified plan and can be distributed or rolled to an IRA along with the rest of their plan benefit.
5. **Qualified Plan Exchange Privilege (QPEP) Rider**
   If there is still a need for life insurance protection, the QPEP rider may be used.[7] This rider allows the Trustee to surrender the life insurance contract and provide the participant with the availability to maintain life insurance coverage for the net amount at risk outside the plan (face value – cash value) without having to purchase it from the plan. The new policy is issued at current age but with no additional medical underwriting.

   Please see the section on the QPEP rider for more information.

If the participant wants to maintain the existing life insurance outside the qualified plan, is it better to pay tax on the cash value accumulation or is it better to buy the life insurance from the plan for its cash value? If the participant has ample monies outside the plan, then buying the life insurance by replacing the cash value with monies from other assets might be the best option. The policy is then individually owned, no tax is incurred on the cash value, and the insured can access the cash values of the life insurance policy to supplement retirement, exercise the ABR riders in case of a terminal, chronic or critical illness, or exercise the Lifetime Income Benefit Rider on products that include that rider.[8]

If the participant cannot buy the life insurance from the plan for its cash value, then paying the tax on the life insurance might be acceptable. A loan could be taken from the policy to pay the tax. Or the loan could be used to reimburse the participant for the tax they incur.

Some other options for the life insurance could be to design the policy to become a paid-up policy in the future. Or use dividends to help offset on-going premiums.

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7 Riders are optional and may be available at additional cost. Riders are not available in all states.

8 Policy loans and withdrawals reduce the policy's cash value and death benefit and may result in a taxable event. Surrender charges may reduce the policy's cash value in early years.

Accelerated Benefit Riders (ABRs) are optional and may not be available in all states. Receipt of Accelerated Benefits will reduce the Cash Value and Death Benefit otherwise payable under the policy, may result in a taxable event, and may affect your client's eligibility for public assistance programs.

The Lifetime Income Benefit Rider provides a benefit for the life of the insured if certain conditions are met, including but not limited to the insured's attained age being between age 60 and 85, and that the policy has been inforce at least 10 years (15 years for LSW SecurePlus Provider.) Insufficient policy values or outstanding policy loans may also restrict exercising the rider. Exercising the rider and receiving an income benefit will reduce the policy's cash value and death benefit and may terminate other riders or reduce their benefits.

The ability to internally fund a life insurance contract will be dependent upon the performance of the contract. Using policy values and benefits to pay the premium due will reduce the policy's cash value and death benefit. If policy values are insufficient to pay the premium, additional out-of-pocket payments may be needed to keep the policy inforce.

Qualified Plan Exchange Privilege (QPEP) Rider

The Qualified Plan Exchange Privilege Rider allows a qualified life insurance policy to be exchanged for a new policy outside of the qualified plan with no additional medical underwriting. This can potentially solve problems that can arise with moving a policy, or a portion of a policy, out of a plan at termination of service, retirement, or due to violation of incidental limits.

The Qualified Plan Exchange Privilege (QPEP) Rider has been in existence non-contractually for many years. Since 2008, the QPEP rider has been contractually included as a rider on the contract*. Therefore, it is non-contractual on policies issued prior to 2008.

Many agents encourage clients to acquire significant life insurance amounts in their qualified retirement plans. The clients recognize the benefits and advantages in using this method for paying their life insurance premiums. However, once they have reached one of the following triggering events, the insurance contracts must be removed from the plan:

- Participant retires or terminates employment with the employer.
- The entire plan is being terminated.
- The plan is discontinuing the life insurance provision.
- Incidental limits have been violated.

Before the QPEP Rider became available, if a plan participant had a triggering event, the options were:

1. Distribute the insurance contract(s) from the plan and the individual would pay income tax on the fair market value, less the aggregate of all prior taxable term costs paid. (If the individual is an unincorporated owner, tax treatment of insurance is different and this taxable term cost recovery is not available.) In addition, a 10% federal tax penalty may be imposed if the individual is under age 59½, unless one of the allowable exceptions applies.

   Disadvantage: The participant will incur a tax and potential penalty on the values upon distribution.

2. Buy the insurance contract(s) from the plan for the fair market value. There would be no taxable distribution if this approach is used. By buying the policy out of the plan, the plan participant is taking an asset out of the plan (the insurance fair market value) but putting an asset of equal value back into the plan. The money going into the plan will roll to the plan side fund account.

   Disadvantage: The participant will have to come up with the money to purchase the contract(s). Also, the economic benefit cost will not apply to the money put into the plan to equal the value of the life insurance policy taken out of the plan.

3. If the individual wishes to reduce any applicable taxable income associated with a distribution of the policy, or the cost of buying the policy from the plan, the Trustees of the plan may take a loan against the policy cash value prior to distribution from the plan. This could substantially lower the policy value, thereby greatly reducing tax on the fair market value.

   Disadvantage: The participant will have to pay interest on the policy loan as well as the net premiums due. Policy loan withdrawals will decrease the policy cash value and death benefit and may result in a taxable event.

QPEP Alternative

QPEP provides an additional option for the life insurance. The policy can be exchanged out of the plan under the QPEP rules.

The old policy must be surrendered, while still owned by the pension trust.

The proceeds from the surrendered contract remain with the pension trust. They would be rolled to the plan's side fund account.

* Riders are optional and may require additional premiums. Riders and products may not be available in all states.

A new policy is written outside of the qualified plan for the net amount at risk of the surrendered policy.

- The new policy is issued at current age.
- There is no medical underwriting.
- Normal issue age availability is used for the new policy.
- Flex Term Rider is available on the new policy up to 25% of the total face amount.*
- Multiple life policies are eligible for the QPEP program subject to the following additional terms:
  – Both insureds under the original policy must be alive.
  – The new policy must be a joint life policy of the same form (i.e., first-to-die or second-to-die)
  – If the original policy is a second-to-die policy and only one of the insureds is still living, the policy may be exchanged under the QPEP program for a single life policy.
- The new policy will be issued as a personally owned policy outside of the pension plan on the basis for the age the insured has attained on the date of exchange. The policy may also be owned by the employer or a trust.
- No evidence of insurability will be required. The class of risk under the new policy will be the same as under the pension policy or the results of the last National Life underwriting review, if later. If the policy was issued prior to the availability of nonsmoker rates, the new policy will be a standard smoker, unless the insured can satisfy nonsmoker criteria.
- The new policy date will be the date of the exchange. The new policy will be issued on a policy form and at a sex distinct premium rate for the insured's attained age in use by the company on the new policy date.
- Normal replacement commissions will apply.
- Restrictions:
  – Minimum policy size: $25,000
  – Maximum policy size: net amount at risk (not to exceed $2,000,000)
  – Reinsured risks are not available

For policies issued since 2008, see the rider attached to the contract for specific details.

Available products for exchange:

TotalSecure WL
FlexLIfe IUL
Peaklife IUL

Requirements and Instructions to Implement the QPEP Rider:

Contact your Service Representative in Contract Change and provide details on any potential QPEP request. Send the following paperwork to Contract Change:

- Request for Withdrawal/Surrender of Funds, Annuities & Qualified Retirement Plans Insurance Form 9871 (Cat #49555). Use this form to terminate the pension policies. QPEP should be noted on the surrender form.
- Original pension policies (unless policies have been retained at the home office). Note: surrendering a policy may not be in the client's best interest. A client and their professional advisors should compare the in-force illustration on the existing policy with the illustration on the replacement policy and consider alternatives to a QPEP surrender.
- Life Insurance Application 8121 (or State special). Complete the Proposed Insured, Owner and Beneficiary, Replacement and Life Insurance in force information section.
  – Under Remarks, insert "QPEP"
  – Sign and date
- Signed illustrations and Replacement Forms, if applicable by State law
- Agent's Report
- New Case Application can be field entered NBFW – Indicate "QPEP"
- Initial Premium

Reminder: The new policy face amount cannot exceed the combined net amount at risk of all pension policies on the insured's life.

Send all of the reduction requirements to: Contract Change.

Distribution Planning

With the numerous distribution options available at retirement, it might be difficult for a plan participant to decide on the most appropriate distribution option for the monies in their plan. If the participant does not want to incur immediate taxation on the side fund account, the money can be rolled to an IRA to defer taxation. Tax can be deferred until age 72, at which time required minimum distributions (RMDs) must begin.

Stretch IRA

Proper structuring of an IRA prior to the owner's death can allow a beneficiary to establish an "inherited" IRA. If the IRA is treated as an inherited IRA, the IRA owner's name must remain on the inherited IRA account title and the account title must indicate that it is an inherited IRA by using the word "beneficiary" or "beneficiary IRA" or "inherited IRA." Some examples of retitling might be "John Smith IRA (deceased 11/27/2015) F/B/O John Smith, Jr., Beneficiary" or "Jane Doe as beneficiary of Sam Doe."

If the beneficiary is a non-spouse beneficiary, the beneficiary may only have 10 years in which to receive payments from the IRA account. The beneficiary can structure the payments in any way that is most suitable for them. They can take equal payments each year for 10 years, or varying amounts. The only stipulation is that the entire IRA account balance be drawn out by the end of the 10 years.

IRA payments can be stretched over the beneficiary's life expectancy in the following situations:

- If the beneficiary is a child under the age of majority the payments can be stretched out over the child's single life expectancy until the child reaches the age of majority. At that time, the child has a remaining 10 years to take the balance of the money from the IRA;
- If the beneficiary is disabled under 72(m)(7) of the Internal Revenue Code*;
- If the beneficiary is chronically ill as defined under IRC 7702B(c)(2)**;
- If the beneficiary is the surviving spouse of the IRA owner.

The beneficiary receives a minimum distribution from the inherited IRA every year thereby "stretching" the income over their lifetime. The remaining balance retains its tax-deferred status. Having other assets to cover estate taxes will allow the heirs to maintain the value in the IRA to stretch over their remaining life expectancy.

With the time value of money, it is possible that the value of the qualified plan assets remaining to be distributed to the heirs using this approach will in fact grow during the early years following the client's death.

*IRC Section 72(m)(7)

**7702B(c)(2) Chronically Ill Individual Defined

An individual shall be considered to be disabled if he/she is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration.

In general – the Term "chronically ill individual" means any individual who has been certified by a licensed health practitioner as –

Being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to a loss of functional capacity,

Having a level of disability similar (as determined under regulations prescribed by the Secretary in consultation with the Secretary of Health and Human Services) to the level of disability described in clause (i), or

Requiring substantial supervision to protect such individual from threats of health and safety due to severe cognitive impairment.

Such terms shall not include any individual otherwise meeting the requirements of the preceding sentence unless within the preceding 12-month period a licensed health care practitioner has certified that such individual meets such requirements.

Activities of daily living – For purposes of subparagraph (A), each of the following is an activity of daily living: Eating, Toileting, Transferring, Bathing, Dressing and Continence.

Stretch IRAs are designed for individuals who will not need the money in the account for their own needs. Most stretch IRAs assume the IRA will a) distribute the smallest amount of money from the IRA that the law allows, b) beneficiaries of the IRA die before reaching their full life expectancy, c) tax laws do not change, d) a constant rate of return despite the fact that account values may vary substantially and cannot be predicted, and e) do not incorporate inflation estimates. Therefore, stretch IRAs must be carefully considered before implementation as assumptions can vary significantly from actual results.

Fair Market Value (FMV)

The fair market value of life insurance policies is determined as the greater of the policy's cash surrender value and the sum of the interpolated fair market value rate, the amount of any unearned premium, and a pro rata portion of the dividend expected to be paid for the current policy year. The fair market value will not be less than the unearned gross premium in the first policy year.

In general, the FMV of a contract distributed from a plan is the stated cash surrender value to determine the amount includable in income.

For Example:

Contract Year	Surrender Value	Contract Reserves
5	$40,000	$153,568
10	$100,000	$374,953
15	$450,000	$450,000

In this scenario if the contract was to be purchased from the plan in year 10, the $100,000 surrender value is not indicative of the FMV and therefore may not be used. The contract reserves of $374,053 more closely relates to FMV and therefore is the value that would determine the sale price from the plan.

There are also safe harbor formulas established by the IRS to determine a contract's FMV. You can read the IRS Final Regulation at http://www.treas.gov/press/releases/402reg.pdf. The safe harbor formula in determining FMV is the greater of:

- The sum of 1) the interpolated terminal reserve plus any unearned premium plus 2) a pro rate portion of a reasonable estimate of dividends expected to be earned for the contract for the year of distribution; or
- The product of 1) the premium earnings and reasonable compensation (PERC), times 2) the applicable average surrender factor.

The calculation of the PERC amount is slightly different when calculating non-variable and variable contracts.[9]

9 A qualified tax professional should always be involved with calculating plan distributions.

Appendix A National Life's Annual Renewal Term

ART Current Premium Rates per Thousand – Policy Year 1.

Level for 1 year: Guaranteed for 1 year. Add $75 Policy Fee.

ATTAINED AGE	ANNUAL PREMIUM PER 1000	ATTAINED AGE	ANNUAL PREMIUM PER 1000
20	0.30	53	0.95
21	0.30	54	1.02
22	0.30	55	1.09
23	0.30	56	1.22
24	0.30	57	1.35
25	0.30	58	1.47
26	0.30	59	1.60
27	0.30	60	1.73
28	0.30	61	1.89
29	0.30	62	2.05
30	0.30	63	2.22
31	0.30	64	2.38
32	0.30	65	2.54
33	0.30	66	2.77
34	0.30	67	3.01
35	0.30	68	3.24
36	0.31	69	3.48
37	0.32	70	3.71
38	0.33	71	4.49
39	0.34	72	5.28
40	0.35	73	6.06
41	0.38	74	6.85
42	0.42	75	7.63
43	0.45	76	7.67
44	0.49	77	8.59
45	0.52	78	9.61
46	0.57	79	10.42
47	0.61	80	11.34
48	0.66	81	12.76
49	0.70	82	14.18
50	0.75	83	15.61
51	0.82	84	17.02
52	0.89	85	18.44

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