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Changing the Future for Me and You—Winning with Tax Deductions and Life Insurance

by Mary Read, CPC, QPA

Abstract: *Entering a new market takes work but can bring big rewards. Selling with qualified plans can shift a financial advisor's business to a new level of consultative sales with successful and profitable business owners. The last quarter of the year is when most qualified plans are sold. If an advisor steps up now, it is possible to close one qualified plan this year. Including life insurance in that plan could lead an advisor to make $30,000 or more on that first sale.*

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Don is the owner of Don's Precision Machining, a small, successful business operating with five employees. Don opened his doors for business when he was 40 and with his hard work his business has thrived.

What might Don's future be? After more than 25 years in business, Don decides he is ready for retirement. None of his children wants to take over the business so Don seeks a buyer. With a depressed economy and a shortage of available credit, Don is not able to find a buyer for his business. With only his house and limited other assets, he determines he needs to continue to work and retirement is not in his immediate future.

What could have happened if a financial advisor had helped Don? Don's Precision Machining established a defined-benefit plan when Don was in his 40s. The plan funded retirement benefits and all the plan contributions were deductible on his business tax return. Don is able to retire when he wants and take a lump sum of more than $2 million from the plan. Don can then roll the money to an IRA where it can continue to grow tax deferred and he can pull out money each year as he needs to for his living expenses. Don can sell off the equipment from his company when he is able to find a buyer and add to his pool of money for retirement.

What happens if Don is less fortunate? Everything does not always go as planned. Suppose Don has the misfortune to become ill or die prematurely? With no retirement plan in place and no life insurance, Don's wife might need to step in and take over operation of the business to generate ongoing income. However, without Don's knowledge or skill there is a strong chance the

business will fail. If Don had established and funded a qualified plan including life insurance, Don's wife and children could be financially secure.

What will change Don's outcome? Meeting with a diligent and skilled financial advisor who steers him to a better future will.

Advisors want their clients to have the better outcomes. Advisors also want successful careers for themselves. But, wanting is not enough to make it so. How is desire turned into action?

Finding prospects, getting their attention and their time is never easy. The story of qualified plans with their tax-deductible contributions is a great story to tell. It is the advisor's job to find someone who will listen.

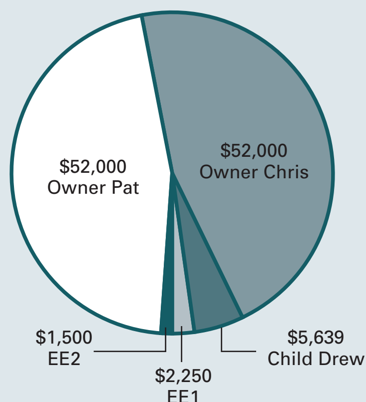
TABLE 1

Employee Compensation

	Age	Compensation
Owner Pat	61	$260,000
Owner Chris	57	$260,000
Child Drew	32	$75,000
Employee 1	27	$45,000
Employee 2	62	$30,000
		$670,000

FIGURE 1

Proportion of Contributions to Qualified Plan



Understanding Some Basics

Qualified plans come in many types. 401(k) plans dominate the marketplace but there are many other types of plans to choose from, each with its strengths. A business owner can receive as much as $52,000 each year in a 401(k) profit-sharing plan but may have a contribution exceeding $200,000 in a defined-benefit plan. Qualified plans for closely held businesses can be effective financial planning tools for the business owner. They can be used to accumulate wealth and can include life insurance purchased with tax-deductible dollars.

The basic concept of the qualified plan is simple. Would the owner of a profitable business rather pay less tax and keep more of what he or she earns? That is what a qualified plan can do for a small business owner. But what about the employees? "Won't I have to contribute for my employees?" is the question foremost on business owners' minds when a conversation about a qualified plan commences. Many business owners are looking for benefits for themselves but not necessarily looking for benefits for their employees. Employees who meet eligibility requirements of one year of service and who are age 21 or older will typically be eligible to participate in the plan. But, an efficiently designed plan will keep the cost for employees to a minimum. In fact, the employees may not cost the employer anything. Contribution and cost are not the same thing. If the plan is efficient, the tax savings resulting from the tax deduction of the plan contribution will exceed the contribution that needs to be made for employees, thus resulting in Uncle Sam paying for the employees. When this happens the employer actually has a net gain, not a net cost, for contributing to the plan.

Consider this example. An employer pays total compensation of $670,000 (Table 1). He contributes a total of $113,389 to a qualified plan (Figure 1). The employer enjoys a tax savings of $38,552 as a result of the deductible plan contribution (Table 2). The contribution for the two employees is only $3,750. The rest of the tax savings goes to work for the owners' family members, resulting in a net gain of $34,802. So the tax savings far outweigh the employee contribution (Figure 2). Did the employer contribute for the employees? Yes. Did the employees cost the employer anything? No.

Why Do Employers Adopt Qualified Plans?

Employers adopt qualified plans for a variety of reasons: for their tax advantages, for meeting their retirement needs, and for their employee benefits. Gaining immediate tax deductions and placing assets beyond the reach of creditors are typically high concerns for business owners and professionals.

Tax Reasons

The tax advantages of qualified plans are as follows:

- Contributions to the plan are tax deductible.
- Contributions are not currently income taxable to the participants.
- Plan earnings grow tax deferred until withdrawn.
- There is no income tax on net insured death benefits.

Retirement Reasons

The retirement reasons employers choose qualified plans are as follows:

- They provide savings at retirement.
- Retirement benefits are guaranteed (guaranteed by employer in defined-benefit plans).
- Funds are generally protected from the claims of creditors.
- Distributions can be rolled to an IRA and stretched over the beneficiary's lifetime.
- There are income-tax-free death benefits. (Net amount at risk in life insurance policy passes income tax free; cash surrender value is taxable.)

Business Reasons

The business reasons employers choose qualified plans are that a qualified plan:

- Enhances employee loyalty;
- Helps attract and retain quality employees;
- Motivates employees;
- Provides retirement security for employees; and
- Reduces the company's current tax obligation.

Seek, Prepare, and Persist

The story of qualified plans with their tax-deductible contributions is a winning story for business owners and CPAs.

An advisor doesn't have to know the intricate workings of every type of plan to start the conversation. A technically savvy person can back up the advisor with all the details. But the advisor does have to be conversant enough to discuss the merits of different plans and why they may be good for the particular business owner the advisor is talking to. There are many resources available to educate advisors. There are books, Webinars, and training sessions available. Insurance companies that issue life insurance in qualified plans will have staff to support qualified plan sales. The Society of Financial Service Professionals offers a qualified section newsletter and Webinars, and often includes sessions on qualified

TABLE 2

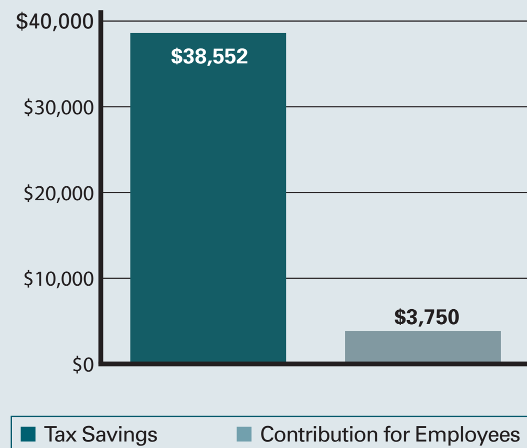
After-Tax Analysis

Sample Case, Profit Sharing

Plan Sponsor's Tax Rate	34%
Total Contribution	$113,389
Tax Savings	$38,552
Net After-Tax Cost of Plan	$74,837
Deposit for Owners & Family	$109,639
Net Gain	$34,802+

FIGURE 2

Tax Savings versus Contribution for Employees



plans at their meetings. Advisors can also learn from experienced agents by working together. Another agent's years of learning can help a less experienced advisor get up the learning curve quickly. Pension Third Party Administrators (TPAs) are often also available to help with technical and sales support.

Who Is the Advisor's Prospect?

Prospects include:

- Successful, profitable businesses with fewer than 10 employees
- Any business entity, including: sole proprietorships, partnerships, LLCs, professional corporations, S corporations, C corporations

Where Can the Advisor Find Prospects?

Prospects are everywhere. The advisor should consider:

- There are 30 million businesses with fewer than 10 employees in the U.S.[1]
- An advisor should begin with businesses he or she already knows. The line of business does not matter. What matters is whether the business is profitable, is paying taxes, and has cash flow that can be used for plan contributions.
- CPAs are strong centers of influence and can refer advisors to their clients once a relationship is built between the advisor and the CPA.
- Businesses with existing plans can be found at http://freeerisa.benefitspro.com/.

How Should an Advisor Approach Prospects?

A few suggestions for the advisor include:

- It is best to start the conversation in person.
- Ask for referrals from existing clients and friends.
- Ask current clients for introductions to their CPAs.

Who Does the Advisor Want to Talk to at the Business?

The advisor should always approach the owner, remembering that what the owner wants is to keep more of what he or she earns.

Will the Advisor Have to Deal with the CPA?

Absolutely, so it is best for the advisor to be prepared, including bringing in help if not confident in making a strong impression. CPAs can be advisors' allies. They are looking for tax deductions for their clients but often do not have the resources to set up qualified plans themselves.

What Is the Advisor Selling?

Key discussion points for the advisor should include the following:

- The qualified plan discussion centers around tax deductions, retirement savings, and protection from creditors.
- Tax deductions are very important to business owners and CPAs. For many business owners and CPAs, when it comes to saving on taxes, "there is no time like the present."
- The advisor should remove a business owner's fear of employee contributions and show how the tax savings of a qualified plan may far exceed any potential employee costs, explaining that the plan is designed around the employer, and employee costs can be surpassed by the money saved in taxes.

What Is the Process of the Sale?

The financial advisor should proceed as outlined below.

1. Identify a prospect.
2. Meet with the prospect and learn his or her goals and objectives. Gather a "fact find," including a census of all the employees with dates of hire, dates of birth, and salaries. Ask the employer key questions: How much do you want to contribute? Which employees do you want to include? Which employees do you want to favor?
3. Obtain a custom plan proposal. Proposals are generally prepared by home office support staff or TPAs.
4. Present the proposal to the prospect, including insurance in the proposal, if desired.
5. Refine the proposal as needed to meet the prospect's needs. It is typical that the proposal will need to be rerun to reflect changes that are defined in conversation with the prospect over the initial proposal.
6. Propose investments for the plan.
7. Retain a TPA.
8. When the client says "yes," complete paperwork for creation of the plan documents following the procedures of the TPA. The client signs the plan documents to establish the plan. Employers with a calendar fiscal year

must sign their plan documents no later than December 31 to receive a deduction for the current year.

9. Submit insurance applications where they apply.
10. TPA provides all required notices for employees.
11. Employer makes contributions.
12. TPA provides ongoing plan administration.

How Can the Advisor Make a Sale Quickly?

Some steps an advisor could take include:

- Identifying people already known who could benefit from a qualified plan;
- Identifying someone to help with the sale, either an experienced producer, home office support, or a TPA;
- Making an initial fact-finding appointment;
- Relying on the expertise of the person helping with the sale to close the case.

Entering a new market takes work but can bring big rewards. Selling with qualified plans can shift an advisor's business to a new level of consultative sales with successful and profitable business owners. The last quarter of the year is when most qualified plans are sold. If an advisor steps up it is possible to close one qualified plan this year. Including life insurance in that plan could lead an advisor to make $30,000 or more on that sale. ■

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(1) Government Census Statistics, www.bls.gov/ncs/ebs/benefits/2010/ownership/private/ table01a.pdf; www.census.gov/epcd/susb/latest/us/US—.HTMcenstats.census.gov/ cgi-bin/nonemployer/nonsect.pl.; U.S. Census Bureau 2007 and 2008; U.S. Department of Labor, U.S. Bureau of Labor Statistics 2010.

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