

IRS PUBLISHES GUIDANCE UNDER SECTION 412(i)

Friday the 13th turned out to be a lucky day for CJA and a devastating day for many of our competitors in the 412(i) marketplace. On that day, the IRS released proposed regulations, a revenue procedure and two revenue rulings designed to combat abusive 412(i) plans. The plans that the IRS has targeted permit contributions in excess of the cost of a participant's retirement benefit, as well as the distribution of an insurance policy at a time when its cash surrender value is artificially low. As you know, CJA's plan design does not permit either strategy.

1. Proposed Regulations

The proposed regulations amend existing regulations under sections 79, 83 and 402 of the Code. The purpose of the proposed regulations is to clarify that the fair market value of property, such as an insurance policy, distributed from a qualified plan may exceed the cash surrender value of the policy. The preamble to the proposed regulations describe the change as providing that:

... the value of all features of a life insurance policy providing an economic benefit to a service provider (including, for example, the value of a springing cash value feature) must be included in determining the employee's income.

Clearly, the proposed regulations seek to put an end to the distribution of a policy at a time when the policy's cash value is artificially low.

2. Revenue Procedure 2004-16

In Rev. Proc. 2004-16, the IRS provides interim rules under which the cash value of a policy may be used as the policy's fair market value. The IRS says that the cash value of the policy, without reduction for surrender charges, may be used to determine the fair market value of the policy provided that the cash value is at least as great as:

1. premiums paid from the date of issue to the date of distribution, plus
2. amounts credited to the policyholder, including interest, dividends and other similar items, minus
3. reasonable mortality charges and other expenses.

3. Revenue Ruling 2004-20

In Rev. Rul. 2004-20, the IRS attacks plans that permit excessive contributions to a qualified plan. The IRS says that a plan cannot qualify as a 412(i) plan if the benefit under the insurance contracts held for a participant exceed the participant's benefit under the plan. This will be the case with plans that permit excessive contributions to a policy that suppresses cash value in the early years with an eye towards distribution of the policy before normal retirement age. In addition, in Rev. Rul. 2004-20, the IRS says that an employer may not deduct that portion of its contribution to a plan that funds a participant's death benefit in excess of the participant's incidental death benefit. The combination of the two provisions of Rev. Rul. 2004-20 limit an employer's contribution to a 412(i) plan for life insurance.

4. Revenue Ruling 2004-21

In Rev. Rul. 2004-21, the IRS restates the obvious. A plan that does not provide the same insurance policy to the rank-and-file as to the key employees cannot satisfy the nondiscrimination rules of section 404(a)(4) of the Code.

A more thorough discussion of these IRS releases will appear in the next CJA newsletter.