Power79 Plan

To Customize
Contact Ken

Prepared for:

Your New Friend CPA

Presented by:

Power Producer
PPNA Agency
123 Main Street
Everywhere, USA

To Customize, contact Ken

	Agenda: 1) Why your client wanted us to meet. 2) What the Plan is all about. 3)Who is PPNA Broker? 4) How PPNA Broker works with CPA Firms
Section 1	**Power 79 Background** **CPA Postcard**
Section 2	**Required Confidentiality Agreement**
Section 3	**The Plan**
Section 4	**CPA Advisor Brief**
Section 5	**Greenberg Traurig– Mamorsky Legal Opinion Letter** **RSM McGladrey Wealth Wisdom Article** **AICPA Wealth Management Insider Article**
Section 6	**Section 79 Code** **Explanation of the valuation for “Permanent Benefits”** **Table 1 Rates**
Section 7	**National Life Technical Guide**
Section 8	**CCH CPA Whitepaper**

Section 1 | Power 79 Background CPA Postcard

Power79 Plan[sm]

Background notes for accounting professionals regarding The Section 79 Program known as the Power79.

As background information . . . The following is the paper trail to our discussion of this Section 79—permanent benefit program for small and medium sized business owners.

The original research including our law firm's legal fees and Treasury Department expense to bring this program into compliance exceeded $155,000 and took almost a year to complete.

Greenberg-Traurig of New York, is one of the largest tax law firms in America. The tax chair for the firm, Jeffrey D. Mamorsky, J.D., L.LM., is our tax attorney. He worked with us and the U.S. Treasury Department to recreate this program and update it. Mr. Mamorsky is also well known in the U.S. legal community as the attorney who wrote the final draft of legislation for the U.S. Congress that we call ERISA. Any attorney who becomes an ERISA attorney or tax attorney must study the work of Mr. Mamorsky to obtain the additional credentials.

Once the above process was completed we applied to the U.S. Copyright office for a copyright on this program. We update that copyright annually.

The insurance company who sponsors the actual product required an extensive review process to vet the program as well:

Program reviewed & approved by:

In-house legal counsel
Outside independent legal counsel
Chief Actuary (level 4 actuary)
Advanced Designs attorneys
Advanced Underwriting attorneys
Chief Compliance attorney
and finally 2 hours of CPE credit for CPAs

Why, because since 1985 CPAs do not receive any formal training on 'Permanent Benefit" Section 79.

We have had 8 audits since 2000, all triggered by <u>other</u> activity of the taxpayer. All deductions requested were allowed to stand as applied for.

And finally . . . we can now show it to you.

Business Owners in 44 states are already using these two *little known*, yet *powerful* code sections to their tax mitigation advantage

find out how.

come join us

for 2 hours of CPE course credits on two little known, but very *powerful* tax mitigation code sections. These code sections provide a variety of unique benefits to business owners. As a *result*, there are business owners in forty-four states using these code sections to their tax mitigation advantage.

CPA/CPE TRAINING - FEATURES OF PROGRAMS

- The programs allow the business owner to remove funds from their business for their own benefit.
- The company deducts the cost of the programs as an ordinary business expense.
- There is no regulatory limit on the funding for the business owner, unlike a qualified plan program.
- The programs remove assets from the reach of company and personal creditors.
- The money in the programs grow on a tax-free basis.
- The programs provide an on-demand, tax-free income at the client's discretion with no early withdrawal tax penalties.
- This is not a qualified plan and does not utilize ERISA regulations.
- The tax consequence for the client is minimal.

EDUCATIONAL BRIEFING – DESCRIPTION:

A unique process of professional practice revenue enhancement will be shown.
As a supplement, following the Continuing Professional Education course, an optional 25 minute presentation - requested by numerous CPA associations and individuals - will be offered.
It details the potential for revenue enhancement not currently utilized by accounting practices. This overview and its information have been received by thousands of CPAs as a powerful revenue enhancer and opportunity to add new business and fee based clientele not currently enjoyed. This background supplement has been implemented by CPAs across the country, resulting in many cases where practice enhancement has added better than 25% more revenue to the accounting firms bottom line profit.
We will present an actual case and ongoing relationships to support this. Please keep in mind that we have provided over 3,500 CPA/CPE training certificates over the past dozen years, along with more than 500 attorneys.

2 HOUR CPA / CPE TRAINING & A SEPARATE EDUCATIONAL BRIEFING ON A UNIQUE PROCESS OF PRACTICE DEVELOPMENT TO ENHANCE REVENUE

Wednesday, Septemember 25, 2013
11:45am- 2:15pm ~ Lunch Meeting
Boulder Ridge Golf Club
1000 Old Quarry Rd., San Jose, CA 95123

Thursday, Septemember 26, 2013
11:45am- 2:15pm ~ Lunch Meeting
Massimo Ristorante
1604 Locust Street, Walnut Creek, CA 94596

A Luncheon Invitation from The BTA Educational Institute

The two program presenters are nationally prominent in the areas of Tax Mitigation and Asset Retention. They have over 85 combined years of experience in Financial Services. As Tax Reduction Specialists to some of America's wealthiest families, business owners and professionals, they have saved their clients significant Income taxes. The CPE courses have taught to approximately 3000 CPAs & 500 Attorneys nationwide.

Register TODAY!

Please email or call to register. Please leave your name, email address, telephone number and location of attendance.
Call Stephen Edward Antic, Managing Director

Questions? Call Registration

BTA Educational Institute
Email: Register@BTAGroup.net
Phone: (925) 736-6171

BTA Educational Institute
4115 Blackhawk Plaza Circle, Suite 100
Danville, CA 94506

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Lee Neidleman
960 Saratoga Ave
San Jose, CA 95129-3429

Section 2	Required Confidentiality Agreement

CONFIDENTIALITY AND NON-CIRCUMVENTION AGREEMENT

THIS CONFIDENTIALITY AND NON-CIRCUMVENTION AGREEMENT (“AGREEMENT”) is Made and entered into the last date indicated below by and between Harbor Financial Partners, LLC, a Wyoming limited liability company having a principal place of business at 31 Bayview Drive South, San Rafael, CA 94111 (“HFP”), its affiliates, successors, and assigns, and the undersigned party, its affiliates, successors, and assigns (“Associate”) (HFP and Associate are individually referred to as a “Party” and collectively as the “Parties”).

WHEREAS, HFP has invested significant resources developing proprietary and confidential systems, methods, solutions, and programs that assist other professionals and their clients with capital transfer, capital compensation deferral, and financial product(s) enhancements.

WHEREAS, Associate desires to receive information regarding HFP’s systems, methods, solutions and programs.

NOW, THEREFORE, intending to be legally bound, the Parties agree as follows:

1. Confidential Information. As used in this Agreement, the term “Confidential Information” means all information disclosed by HFP to Associate, whether or not reduced to writing, related to financial services, employee benefits, and efficient ways to utilize employee benefits to achieve cash flow improvements, strategies and methods related to design of products and services, and other information related to HFP’s business that is of value to HFP and not generally known to the public. Information shall not be considered “Confidential Information” if Associate can establish by clear and convincing evidence with its written records kept in the ordinary course of its business that: (i) the information was public knowledge at the time of disclosure; the information has become public knowledge at the time of disclosure; (iii) the information was known to Associate at the time of the disclosure; (iv) the information was lawfully obtained without restriction on use, from a third party not under obligation of confidentiality to HFP; or (v) the information was independently developed by Associate without access to or use of HFP’s Confidential Information.

2. Covenants of Confidentiality. Except as expressly set forth in writing signed by HFP, Associate shall not use or disclose HFP’s Confidential Information for any purpose other than to evaluate receiving services, products, or plans from HFP, its affiliates or vendors. Associate agrees to maintain in confidence and prevent the unauthorized use and or disclosure of the Confidential Information and shall not use or disclose the Confidential Information except as authorized in writing by HFP. Upon request for any reason, and within ten (10) days following Associate’s receipt of a written request from HFP, Associate shall (a) deliver to HFP all tangible materials containing or embodying the Confidential Information and certify the same to HFP in writing. These Covenants shall survive for the longer of seven (7) years after the date of this Agreement. or for such time as the Confidential Information remains a trade secret under applicable law.

3. Covenants of Non-Circumvention. In consideration of HFP granting Associate access to the Confidential Information, Associate, on behalf of itself and its affiliates, successors, and assigns, covenants and agrees that it shall not, directly or indirectly, circumvent HFP’s rights to be paid it stated fees or other monetary reward(s) for providing Associate access to HFP’s services, products, or professionals.

4. Equitable Relief. If a breach of this Agreement occurs or is threatened, HFP shall be entitled to seek and obtain (a) injunctive relief restraining Associate from using or disclosing, in whole or in part, comply with its covenants hereunder; (b) specific performance to require Associate to comply with its covenants hereunder; (c) and other equitable relief that may be ordered by a court of law; and (d) recovery from damages, losses, and expenses of any nature, including without limitation, attorneys’

5. Miscellaneous: This Agreement constitutes the entire agreement between the Parties with respect to the subject matter thereof, previous representations, proposals and discussions, whether oral or written, between the Parties concerning the subject matter hereof. No amendment of the Agreement shall be binding upon the Parties unless made in writing and duly signed by both Parties. Failure by HFP to enforce any provision of this agreement shall not be construed to be a waiver of such provision or its rights thereafter to enforce such provision or any other provision. This Agreement shall be governed by the internal laws of the State of California. All disputes, controversies or claims arising out of or relating to this Agreement or the relationship between the Parties, shall be brought in the state and federal courts located in California. This Agreement shall be binding upon and shall inure to the benefit of the Parties hereto, their parents, subsidiaries, affiliates, employers, shareholders, officers, and directors, and their respective heirs, successors, representatives and assigns. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, HFP and Associate have executed the Agreement as of the last date below.

HARBOR FINANCIAL PARTNERS, LLC	ASSOCIATE
	--_ (Print Name)
By____	By ____
Its____	Its ____
Date______________________________________	Date____

CONFIDENTIALITY AND NON-CIRCUMVENTION A G R E E M E N T

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IN WITNESS WHEREOF, HFP and Associate have executed the Agreement as of the last date below.

HARBOR FINANCIAL PARTNERS, LLC	ASSOCIATE
	______________________________ (Print Name)
By______________________________	By ______________________________
Its______________________________	Its ______________________________
Date______________________________	Date______________________________

Section 3 | The Plan

Power79 Plan[sm]

"If we could show you a way to move $ from your business to yourself in a very tax efficient manner, and your CPA thought it was a good idea, is there any reason you wouldn't want to know about it?

The Net Differential

Power79 Plan

What would you think if:

Perfect Investment:

Assume we invest **$100,000** and achieve a **50% rate of return** with the following attributes:

- No Taxes
- No Fund Management Expenses
- No Commissions or Transactions Costs…

Power79 Plan

Your $100,000 investment has grown to **$150,000!**

Power79 Plan

The $100,000 investment is a net figure.

If we consider and account for our taxes, assuming a 40% tax obligation, then the gross income needed to have had a net $100,000 is $167,000!

Power79 Plan

The $100,000 investment is a net figure.

If we consider and account for our taxes, assuming a 40% tax obligation, then the gross income needed to have had a net $100,000 is $167,000!

Simply multiply $167,000 by .6 (60%)

And now you have your net: $100,000

Power79 Plan

So what sounded so wonderful now reveals itself to be a net loss of $16,667!

Gross Income to invest $100,000:	**$166,667**
The fund value at the end of one year is:	**- $150,000**
Net loss to taxation:	**{$16,667}**

Power Plus Economic Plans *sm*

Let's remove the 50% return and use a more realistic 8%

Gross Income to invest $100,000:	**$166,667**
The fund value at the end of one year is:	**- $108,000**
Net loss to taxation:	**{$58,667}**

Does waiting 8+ years to break even feel like accumulation?

The Cost of After Tax Capital

vs.

The Cost of Tax Deductible Capital

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Assumed Tax Rate Percentage: **40%**

Net Capital: **$100,000**

Actual Gross Capital Needed: **$166,667**

Just like we discovered with the "Peter Pan Investment Plan", in a 40% tax bracket, the actual cost for $100,000 is:

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Assumed Tax Rate Percentage:	**40%**
Net Capital:	**$100,000**
Taxes on Net Capital:	$40,000
Actual Gross Capital Needed:	**$166,667**

Your actual tax due is:

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Assumed Tax Rate Percentage:	**40%**
Net Capital:	**$100,000**
Taxes on Net Capital:	$40,000
Total Dollars Needed to Net 100K:	**$166,667**

Unlike your state incomes taxes, if applicable, federal income taxes are <u>not</u> tax deductible…

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Assumed Tax Rate Percentage:	**40%**
Net Bonus:	**$100,000**
Taxes on Bonus:	$40,000
Total Dollars Needed to Net Bonus:	**$166,667**

Unlike your state incomes taxes, if applicable, Federal Income Taxes are <u>not</u> tax deductible…

Therefore, you actually get taxed twice!

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Assumed Tax Rate Percentage:	**40%**
Net Bonus:	**$100,000**
Taxes on Bonus:	$40,000
Total Dollars Needed to Net Bonus:	**$166,667**

Unlike your state incomes taxes, if applicable, Federal Income Taxes are <u>not</u> tax deductible…

Therefore, you actually get taxed twice!

Why?

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Assumed Tax Rate Percentage:	**40%**
Net Bonus:	**$100,000**
Taxes on Bonus:	$40,000
Gross Income Needed to Pay Taxes:	**$66,667**
Total Dollars Needed to Net Bonus:	**$166,667**

Unlike your state incomes taxes, if applicable, Federal Income Taxes are <u>not</u> tax deductible…

Therefore, you actually get taxed twice!

Because you have to earn $66,667 to net the $40,000.

Cost of After Tax Capital

Gross Income Needed to Net: $100,000

Assumed Tax Rate Percentage:	**40%**
Net Bonus:	**$100,000**
Taxes on Bonus:	$40,000
Gross Income Needed to Pay Taxes:	**$66,667**
Total Dollars Needed to Net Bonus:	**$166,667**

Unlike your state incomes taxes,
if applicable, Federal Income Taxes
are <u>not</u> tax deductible…

Therefore, you actually get taxed
twice!

Because you have to earn $66,667
to net the $40,000.

And you've ended up paying taxes twice,
with an additional $26,667 .

The use of employee benefits plans typically provide meaningful tax relief.

Health ins. – no imputed income for benefits

Pension Plans – Deductible, Deferred

Permanent Benefit Group Life – close cousin

Qualified Pension Plan	Permanent Benefit Group Life Plan
Comparing Features and Benefits	
Tax Deductible funding	Tax Deductible funding
Funding is **fully excludable** from personal income	Funding is **partially excludable** from personal income
Plan assets accumulate on a tax-deferred basis	Plan assets accumulate on a tax-deferred basis
Has a funding test as part of its non-discrimination testing	Plan must offer the same coverage options by type, but with **no funding test**
Income **distributions are fully taxable**	**Income distributions can be tax-free** , via policy loans
Distributions are **subject to age based rules** and limitations	**No age based distribution rules** or restrictions
Can co-exist with Group Life	Can co-exist with QPP

*Power79 Plan*sm

Key Plan Benefits Summary for Business Owners:

- Tax efficient capital transfer from your business to yourself
- No statutory funding maximums
- Plan assets grow without being subject to income taxation
- Accessibility to plan capital without age distribution rules
- Plan assets can be distributed income tax-free
- Excellent way to create and capitalize your own “private bank”
- The perfect solution to estate liquidity, without losing control

Executive Plan

AN INNOVATIVE SUPPLEMENTAL RETIREMENT PLAN FOR BUSINESSES & PROFESSIONALS

A plan with an investment account, and retirement income benefits, that is designed to pay your taxes from the plan rather than out-of-pocket.

- Deductible to your business or professional practice
- Available as a benefit for key personnel in your business
- Account available without age restrictions or limits
- Income tax-free distributions

Example: Age 50 - $100,000 Annual Contribution for 5 Years

Year	Annual Funding	Deductible Contributions by Business/Practice	*W-2 to Executive	*Net Cost in 40% Tax Bracket
1	$100,000	$100,000	$60,000	$24,000
2	$100,000	$100,000	$60,000	$24,000
3	$100,000	$100,000	$60,000	$24,000
4	$100,000	$100,000	$60,000	$24,000
5	$100,000	$100,000	$60,000	$24,000
Totals	500,000	$500,000	$300,000	120,000

Income Tax-Free Retirement Distributions (Age 65 thru 100)	$80,000 X 36 Years
Total 36 Year Tax Free Retirement Distributions	$2,880,000
Taxable Comparison at 40% Tax Obligation	$4,800,000
Estimated Income Tax (in 40% Tax Obligation) as a percentage of Benefit Received: ($120,000 Taxes Paid - $4,800,000 Benefit Received)	2.5%

*The plan can be designed to pay your income taxes associated with the above referenced W-2 income and is also available without this feature. W-2 income and taxes are estimates and can fluctuate. This example is not intended to provide tax and/or legal advice, nor should they be relied upon as such.

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Cost of After Tax Capital

Traditional Section 79 Plan

An Example of Two Tax Senarios at a Given Tax Rate

	Cost of After Tax Capital		60% Taxable	40% Exempt	
Assumed Tax Rate Percentage:	**40%**				
Bonus:	**$100,000**		$60,000	$40,000	
Taxes on Bonus:	$40,000		$24,000	n/a	
Gross Income to Net Payable Tax:	$66,667		$40,000	n/a	
Dollars Needed to Net:	**$166,667**		$100,000	$40,000	**$140,000**

Yr.	Net Differential	Net Differential Invested			
		2%	**3%**	**4%**	**5%**
1	26,666.67	27,200.00	27,466.67	27,733.33	28,000.00
2	53,333.33	54,944.00	55,757.33	56,576.00	57,400.00
3	80,000.00	83,242.88	84,896.72	86,572.37	88,270.00
4	106,666.67	112,107.74	114,910.29	117,768.60	120,683.50
5	133,333.33	141,549.89	145,824.26	150,212.68	154,717.68

Cost of After Tax Capital

Traditional Section 79 Plan

An Example of Two Tax Senarios at a Given Tax Rate

			60% Taxable	40% Exempt	
Assumed Tax Rate Percentage:	40%				
Bonus:	$100,000		$60,000	$40,000	
Taxes on Bonus:	$40,000	**Double Taxation**	$24,000	n/a	
Gross Income to Net Payable Tax:	$66,667		$40,000	n/a	
Dollars Needed to Net:	**$166,667**		$100,000	$40,000	**$140,000**

Yr.	Net Differential	Net Differential Invested			
		2%	**3%**	**4%**	**5%**
1	26,666.67	27,200.00	27,466.67	27,733.33	28,000.00
2	53,333.33	54,944.00	55,757.33	56,576.00	57,400.00
3	80,000.00	83,242.88	84,896.72	86,572.37	88,270.00
4	106,666.67	112,107.74	114,910.29	117,768.60	120,683.50
5	133,333.33	141,549.89	145,824.26	150,212.68	154,717.68

Section 79 Permanent Benefit Plan

Yr.	Age	Annual Corporate Outlay	W-2 Imputed Income	Est. P.B. Tax 40%	Table 1 Tax 40%	Annual Tax-Free Loan	Cumul. Net Differential	Net Accum. Value	Net Death Benefit
1	50	100,000	60,000	24,000	1,964		26,667	50,843	1,829,362
2	51	100,000	60,000	24,000	2,027		53,333	107,382	1,885,901
3	52	100,000	60,000	24,000	2,096		80,000	169,686	1,948,205
4	53	100,000	60,000	24,000	2,169		106,667	235,878	2,014,397
5	54	100,000	60,000	24,000	2,267		133,333	325,322	2,103,841
6	55						etc.	334,971	2,113,490
7	56							358,318	2,136,837
8	57							397,912	906,724
9	58							453,470	962,282
10	59							475,964	984,776
16'	65					80,000		707,027	1,152,685
17	66					80,000		688,982	1,065,771
18	67					80,000		672,508	974,076
19	68					80,000		658,077	877,338
20	69					80,000		646,273	823,243
21	70					80,000		625,144	804,034
22	71					80,000		604,963	772,145
23	72					80,000		586,004	738,563
24	73					80,000		568,589	703,222
25	74					80,000		553,094	666,060
26	75					80,000		539,964	627,034
36	85					80,000		591,863	777,103
46	95					80,000		1,425,246	1,503,279
51	100					80,000		2,588,064	2,701,902

Summary Analysis For: Sample Client

Assumed Annual - Non Taxable Income - Using Loan Provision:	**$80,000**
Taxable Comparison in a 40% Tax Bracket:	**$133,333**
Total Non Taxable Income - Age 65 thru Age 100 :	**$2,880,000**
Taxable Comparison in a 40% Tax Bracket:	**$4,800,000**

This proposal is funded with an equity indexed adjustable life insurance policy issued by The Pacific Life Insurance Company. Please see the actual Pacific Life Policy Illustration for complete details about the policy. This presentation is for concept illustration purposes only whereby the benefits enjoy certain tax advantages from code and regulations pertaining to Section 79 Group Life Insurance. The projected financial economics expressed herein are subject to change and are not guaranteed.

Cost of After Tax Capital

Power79 Plan℠

An Example of Two Tax Senarios at a Given Tax Rate

			60% Taxable	Net Amount Paid Out of Pocket	40% Exempt
Assumed Tax Rate Percentage:	**40%**				
Bonus:	**$100,000**		$60,000	$60,000	$40,000
Taxes on Bonus:	$40,000		$24,000	0 - Paid by Plan	n/a
Gross Income to Net Payable Tax:	$66,667		$40,000	0 - Paid by Plan	n/a
Dollars Needed to Net:	**$166,667**		$100,000	$60,000	$40,000
				$100,000	

Yr.	Net Differential	Net Differential Invested 2%	3%	4%	5%
1	66,666.67	68,000.00	68,666.67	69,333.33	70,000.00
2	133,333.33	137,360.00	139,393.33	141,440.00	143,500.00
3	200,000.00	208,107.20	212,241.80	216,430.93	220,675.00
4	266,666.67	280,269.34	287,275.72	294,421.50	301,708.75
5	333,333.33	353,874.73	364,560.66	375,531.70	386,794.19

Power79 Permanent Benefit Plan

Yr.	Age	Annual Corporate Outlay	Est. W-2 Imputed Income	Est. P.B. Tax 40%	Annual Loan Interest at 5%	Cumul. Loan Balance	Bank Loan Repayment	Annual Tax-Free Dist. Loan	Cumul. Net Differential	Net Accum. Value	Net Death Benefit
1	50	100,000	60,000	24,000	1,200	24,000			66,667	50,843	1,829,362
2	51	100,000	60,000	24,000	2,400	48,000			133,333	107,382	1,885,901
3	52	100,000	60,000	24,000	3,600	72,000			200,000	169,686	1,948,205
4	53	100,000	60,000	24,000	4,800	96,000			266,667	235,878	2,014,397
5	54	100,000	60,000	24,000	6,000	120,000			333,333	325,322	2,103,841
6	55				4,800	96,000	24,000	24,000	etc.	310,245	2,088,764
7	56				3,600	72,000	24,000	24,000		307,431	2,085,950
8	57				2,400	48,000	24,000	24,000		319,417	827,911
9	58				1,200	24,000	24,000	24,000		345,842	854,336
10	59				0	0	24,000	24,000		337,592	846,086
16	65							73,000		521,989	967,899
17	66							73,000		500,686	878,358
18	67							73,000		480,743	783,895
19	68							73,000		462,616	684,240
20	69							73,000		446,870	622,778
21	70							73,000		421,709	599,485
22	71							73,000		397,253	563,358
23	72							73,000		373,761	525,305
31	80							73,000		254,163	380,361
41	90							73,000		473,321	739,100
51	100							73,000		2,039,158	2,151,907

Summary Analysis For: Sample Client

Assumed Annual - Non Taxable Income - Using Loan Provision:	**$73,000**
Taxable Comparison in a 40% Tax Bracket:	**$121,667**
Total Non Taxable Income - Age 65 thru Age 100:	**$2,628,000**
Taxable Comparison in a 40% Tax Bracket:	**$4,380,000**

This proposal is funded with an equity indexed adjustable life insurance policy issued by The Pacific Life Insurance Company. Please see the actual Pacific Life Policy Illustration for complete details about the policy. This presentation is for concept illustration purposes only whereby the benefits enjoy certain tax advantages from code and regulations pertaining to Section 79 Group Life Insurance. The projected financial economics expressed herein are subject to change and are not guaranteed.

Cost of After Tax Capital

Power79 Plan℠

An Example of Two Tax Senarios at a Given Tax Rate

Assumed Tax Rate Percentage:	**40%**		60%	Net Amount Paid	40%
			Taxable	Out of Pocket	Exempt
Bonus:	**$124,000**		$74,400	$74,400	$49,600
Taxes on Bonus:	$49,600		$29,760	0 - Paid by Plan	n/a
Gross Income to Net Payable Tax:	$82,667		$49,600	0 - Paid by Plan	n/a
Dollars Needed to Net:	**$206,667**		$124,000	$74,400	$49,600
				$124,000	

Yr.	Net Differential	Net Differential Invested			
		2%	**3%**	**4%**	**5%**
1	82,666.67	84,320.00	85,146.67	85,973.33	86,800.00
2	165,333.33	170,326.40	172,847.73	175,385.60	177,940.00
3	248,000.00	258,052.93	263,179.83	268,374.36	273,637.00
4	330,666.67	347,533.99	356,221.89	365,082.66	374,118.85
5	413,333.33	438,804.67	452,055.22	465,659.30	479,624.79

Power79 Permanent Benefit Plan

Yr.	Age	Annual Corporate Outlay	Est. W-2 Imputed Income	Est. P.B. Tax 40%	Annual Loan Interest at 5%	Cumul. Loan Balance	Bank Loan Repayment	Annual Tax-Free Dist. Loan	Cumul. Net Differential	Net Accum. Value	Net Death Benefit
1	50	124,000	74,400	29,760	1,488	29,760			82,667	63,138	2,268,497
2	51	124,000	74,400	29,760	2,976	59,520			165,333	133,328	2,338,687
3	52	124,000	74,400	29,760	4,464	89,280			248,000	210,655	2,416,014
4	53	124,000	74,400	29,760	5,952	119,040			330,667	292,797	2,498,156
5	54	124,000	74,400	29,760	7,440	148,800			413,333	403,808	2,609,167
6	55				5,952	119,040	29,760	29,760	etc.	385,223	2,590,582
7	56				4,464	89,280	29,760	29,760		381,851	2,587,210
8	57				2,976	59,520	29,760	29,760		396,841	1,028,287
9	58				1,488	29,760	29,760	29,760		429,734	1,061,180
10	59				0	0	29,760	29,760		419,627	1,051,073
16	65							92,000		647,676	1,201,319
17	66							92,000		619,860	1,088,667
18	67							92,000		593,660	969,823
19	68							92,000		569,642	844,446
20	69							92,000		548,505	767,117
21	70							92,000		515,573	736,512
22	71							92,000		483,426	689,865
23	72							92,000		452,382	640,729
31	80							92,000		284,847	441,715
41	90							92,000		516,437	845,259
51	100							92,000		2,337,516	2,476,094

Summary Analysis For: Sample Client

Assumed Annual - Non Taxable Income - Using Loan Provision:	**$92,000**
Taxable Comparison in a 40% Tax Bracket:	**$153,333**
Total Non Taxable Income - Age 65 thru Age 100:	**$3,312,000**
Taxable Comparison in a 40% Tax Bracket:	**$5,520,000**

This proposal is funded with an equity indexed adjustable life insurance policy issued by The Pacific Life Insurance Company. Please see the actual Pacific Life Policy Illustration for complete details about the policy. This presentation is for concept illustration purposes only whereby the benefits enjoy certain tax advantages from code and regulations pertaining to Section 79 Group Life Insurance. The projected financial economics expressed herein are subject to change and are not guaranteed.

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Client Census

Jones and Associates, Inc.

Principal Party	Age	W-2 Salary	Annual Funding	Minimum Death Benefit
Don Jones	**50**	**$365,000**	**$100,000**	**$2,310,028**

Qualifying Employees:

Employee	Age	Sex	Salary	Death Benefit	Option1 Permanent Benefit Ins. Premium	Option1 Permanent Benefit Ins. Taxed Income	Option 2 Full Benefit Term Premium	Option 2 Full Benefit Term Taxed Income	Option 3 $50,000 Base Term Ins. Premium	Option 3 $50,000 Base Term Ins. Taxed Income
Lisa S.	35	F	$55,000	$350,900	$1,786	$3,549	$340	$325	$98	$0
David E.	46	M	$63,350	$404,173	$3,872	$7,217	$423	$638	$140	$0
Gerald C	42	M	$31,685	$202,150	$1,603	$3,102	$255	$183	$124	$0
William K.	37	M	$69,250	$441,815	$2,810	$5,581	$260	$423	$110	$0
Diane A.	25	F	$21,150	$134,937	$620	$1,855	$115	$51	$94	$0
Kate F.	49	F	$38,000	$242,440	$2,335	$4,329	$428	$347	$138	$0
Martha C.	33	F	$25,000	$159,500	$746	$1,852	$115	$105	$96	$0
Angie S.	55	F	$42,560	$271,533	$3,552	$6,004	$480	$1,143	$168	$0
Beverly G.	27	F	$22,500	$143,550	$524	$1,013	$135	$68	$94	$0
Totals:					**$17,848**		**$2,551**		**$1,062**	

Full-time employees will receive a death benefit equal to **6.38 X** their annual salary - minimum insurance of $50,000.

The Provided Census Analysis is hypothetical and for illustration purposes only. An actual census analysis will be prepared upon the receipt of actual data.

Section 4 CPA Advisor Brief

*Power79 Plan*sm

GROUP LIFE INSURANCE
PERMANENT BENEFIT PLANS

ADVISOR BRIEF

FOR TAX and LEGAL COUNSEL

Section 79 - Features, Advantages, and Benefits
Plan Description with Permanent Benefits

Section 79 Programs can offer a number of distinct advantages to a closely held business owner or medical professional and benefit from very clear, comprehendable guidance under the Regulations that govern group life insurance plans. All contributions to the plan are tax deductible as a normal business expense, while only a portion of the amounts are includible in the participant's income. Under the Plan, assets, in the form of life insurance policy cash values, accumulate on a tax deferred basis. In the event of the Participant's death, the plan provides an income tax-free death benefit. Once the Plan is terminated, the Participant has the option of receiving income tax-free distributions, via policy loans, that can be structured for, but not limited to, a retirement income stream.

The Program affords an opportunity to provide corporate sponsored group life insurance as an employee benefits plan under Section 79. So long as the employer is not directly or indirectly a beneficiary of the insurance, all employer contributions for premiums are deductible as a business expense and the employee is not taxed on the first $50,000 of coverage. *IRC Sections 79(b)(2), 264(a)(1), and Treasury regulation 1.79-2(c)(2).*

Code Section 79 requires the amount of insurance offered to qualifying, full-time employees be determined under a formula that precludes individual selection. The formula must be based on factors such as age, compensation, years of service, or employment position. Under the Plan, the face amount of insurance offered to each full-time employee is based on a uniform multiple of W-2 income.

An employer can provide group term life insurance to employees in amounts greater than $50,000 and to the extent they do so, the employer must report the cost of this excess coverage, under Table 1, on the employee's W-2 as additional compensation. *IRC 6052 Treasury Regulation 1.79-3(d)(2)*

Moreover, a group term life insurance plan may additionally provide plan participants with "Permanent Benefits". The Regulations define a "Permanent Benefit" as an economic value extending beyond one policy year, for example, a paid-up or cash surrender value that is provided under a life insurance policy. The following features, as per the Regulations, are NOT "Permanent Benefits":

I. A right to convert or continue life insurance in the event of/or after the plan of group life insurance terminates; or
II. Any other feature that provides no economic benefit other than current insurance protection to the employee; or
III. A feature under which term life insurance is provided at a level premium for a period of (5) five years or less. Treasury Regulation 1.79-0.

PERMANENT BENEFITS AND NON-DISCRIMINATION RULES

Term life insurance coverage can be combined with life insurance providing a permanent benefit under the same group policy or group of individual policies, but only if the following conditions are met:

I. If an insurance policy provides permanent benefits to an employee, the cost of the permanent benefits reduced by the amount paid for permanent benefits by the employee is included in the employee's income.

II. The cost of the permanent benefits is determined under the formula in Treasury Regulation 1.79 in paragraph (d)(2).

III. The Policy or the employer must designate in writing, the part of the death benefit to each employee that is group term life insurance; and

IV. The part of the death benefit that is provided to an employee and designated as the group-term life insurance benefit for any policy year is not less than the difference between the total death benefit provided under the policy and the employee's "deemed death benefit" (DDB) at the end of the policy year determined under Treasury regulation 1.79(d)(3)

Employees may elect voluntarily to reduce the amount of their group term life insurance coverage by:

I. Multiples of $10,000 increments;

II. By multiples of 10% of their highest eligible compensation; or

III. Exactly to a minimum of $50,000, but no lower when employer sponsored coverage reached this amount from sponsored sources. See PLR9101021 and PLR9319026.

The rationale for the forgoing is to avoid an employee to be compelled to accept a benefit that would require them to pay out-of-pocket expenses either directly, or in the form of increased reportable income.

Non-Discrimination Rules in General

A plan is non-discriminatory as to eligibility if any one of the following four criteria is met:

I. The plan benefits at least 70% of all employees; or

II. At least 85% of all participating employees are not "key Employees" as defined in IRC 416(i)(1); or,

III. Eligibility is based on a classification set by the employer and not found to be discriminatory by the Secretary of the Treasury; or in the case where the plan is part of a Cafeteria Plan, and the requirements of Section 125 are met. For the purposes of these tests, all employees of related employers are considered.

Certain types of employees can be excluded from consideration, such as employees who are covered by a collective bargaining agreement. Employees who have not completed three years of full-time service, and part-time employees not working more than 20 hours per week, and seasonal employees not working more than 5 months per calendar year. IRC Section 79(d)(2)(b).

The proposed section 79 plan requires all eligible plan participants be offered the options to elect the same type(s) of benefits offered to “key employees”, e.g.; permanent benefits. Additionally, the plan requires that all employees be offered a non-discriminatory amount of benefits by mandating all being offered life insurance in an amount that represents a uniform percentage or multiple of employee W-2 compensation. *IRC Section 79(d)(5)*

Companies with fewer than 10 Employees

If the covered employee group includes fewer than 10 employees, the following rules apply:

I. All full-time employees must be covered, except those who cannot provide satisfactory evidence of insurability if the plan requires it. Evidence of insurability, if required, is limited to a medical questionnaire. *Treasury Regulation 1.79-(c)(2)(i).*

II. The amount of insurance coverage must be computed under a uniform formula such as the uniform percentage of compensation method, and waiting periods for participation is not to exceed six months. *Treasury Regulation 1.79-(c)(2)(ii)*

Our Section 79 plan does not require employees to contribute to the cost of permanent benefits to obtain term life insurance; although employees are responsible to pay income taxes generated by coverage they elect in excess of the free to them, safe harbor $50,000 coverage amount, when an election includes permanent benefits, the employee bears the cost of taxation associated with their choice.

Electronic Code of Federal Regulations

e-CFR Data is current as of February 13, 2014

Title 26: Internal Revenue

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§1.79-1 Group-term life insurance—general rules.

(a) *What is group-term life insurance?* Life insurance is not group-term life insurance for purposes of section 79 unless it meets the following conditions:

(1) It provides a general death benefit that is excludable from gross income under section 101(a).

(2) It is provided to a group of employees.

(3) It is provided under a policy carried directly or indirectly by the employer.

(4) The amount of insurance provided to each employee is computed under a formula that precludes individual selection. This formula must be based on factors such as age, years of service, compensation, or position. This condition may be satisfied even if the amount of insurance provided is determined under a limited number of alternative schedules that are based on the amount each employee elects to contribute. However, the amount of insurance provided under each schedule must be computed under a formula that precludes individual selection.

(b) *May group-term life insurance be combined with other benefits?* No part of the life insurance provided under a policy that provides a permanent benefit is group-term life insurance unless—

(1) The policy or the employer designates in writing the part of the death benefit provided to each employee that is group-term life insurance; and

(2) The part of the death benefit that is provided to an employee and designated as the group-term life insurance benefit for any policy year is not less than the difference between the total death benefit provided under the policy and the employee's deemed death benefit (DDB) at the end of the policy year determined under paragraph (d)(3) of this section.

(c) *May a group include fewer than 10 employees?* (1) As a general rule, life insurance provided to a group of employees cannot qualify as group-term life insurance for purposes of section 79 unless, at some time during the calendar year, it is provided to at least 10 full-time employees who are members of the group of employees. For purposes of this rule, all life insurance provided under policies carried directly or indirectly by the employer is taken into account in determining the number of employees to whom life insurance is provided.

(2) The general rule of paragraph (c)(1) of this section does not apply if the following conditions are

met:

(i) The insurance is provided to all full-time employees of the employer or, if evidence of insurability affects eligibility, to all full-time employees who provide evidence of insurability satisfactory to the insurer.

(ii) The amount of insurance provided is computed either as a uniform percentage of compensation or on the basis of coverage brackets established by the insurer. However, the amount computed under either method may be reduced in the case of employees who do not provide evidence of insurability satisfactory to the insurer. In general, no bracket may exceed 2½ times the next lower bracket and the lowest bracket must be at least 10 percent of the highest bracket. However, the insurer may establish a separate schedule of coverage brackets for employees who are over age 65, but no bracket in the over-65 schedule may exceed 2½ times the next lower bracket and the lowest bracket in the over-65 schedule must be at least 10 percent of the highest bracket in the basic schedule.

(iii) Evidence of insurability affecting employee's eligibility for insurance or the amount of insurance provided to that employee is limited to a medical questionnaire completed by the employee that does not require a physical examination.

(3) The general rule of paragraph (c)(1) of this section does not apply if the following conditions are met:

(i) The insurance is provided under a common plan to the employees of two or more unrelated employers.

(ii) The insurance is restricted to, but mandatory for, all employees of the employer who belong to or are represented by an organization (such as a union) that carries on substantial activities in addition to obtaining insurance.

(iii) Evidence of insurability does not affect an employee's eligibility for insurance or the amount of insurance provided to that employee.

(4) For purposes of paragraph (c) (2) and (3) of this section, employees are not taken into account if they are denied insurance for the following reasons:

(i) They are not eligible for insurance under the terms of the policy because they have not been employed for a waiting period, specified in the policy, which does not exceed six months.

(ii) They are part-time employees. Employees whose customary employment is for not more than 20 hours in any week, or 5 months in any calendar year, are presumed to be part-time employees.

(iii) They have reached the age of 65.

(5) For purposes of paragraph (c) (1) and (2) of this section, insurance is considered to be provided to an employee who elects not to receive insurance unless, in order to receive the insurance, the employee is required to contribute to the cost of benefits other than term life insurance. Thus, if an employee could receive term life insurance by contributing to its cost, the employee is taken into account in determining whether the insurance is provided to 10 or more employees even if such

employee elects not to receive the insurance. However, an employee who must contribute to the cost of permanent benefits to obtain term life insurance is not taken into account in determining whether the term life insurance is provided to 10 or more employees unless the term life insurance is actually provided to such employee.

(d) *How much must an employee receiving permanent benefits include in income?*—(1) *In general.* If an insurance policy that meets the requirements of this section provides permanent benefits to an employee, the cost of the permanent benefits reduced by the amount paid for permanent benefits by the employee is included in the employee's income. The cost of the permanent benefits is determined under the formula in paragraph (d)(2) of this section.

(2) *Formula for determining cost of the permanent benefits.* In each policy year the cost of the permanent benefits for any particular employee must be no less than:

$X(DDB_2 - DDB_1)$

where

DDB_2 is the employee's deemed death benefit at the end of the policy year:

DDB_1 is the employee's deemed death benefit at the end of the preceding policy year; and

X is the net single premium for insurance (the premium for one dollar of paid-up whole-life insurance) at the employee's attained age at the beginning of the policy year.

(3) *Formula for determining deemed death benefit.* The deemed death benefit (DDB) at the end of any policy year for any particular employee is equal to—

R/Y

Where—

R is the net level premium reserve at the end of that policy year for all benefits provided to the employee by the policy or, if greater, the fair market value of the policy at the end of that policy year; and

Y is the net single premium for insurance (the premium for one dollar of paid-up, whole life insurance) at the employee's age at the end of that policy year.

(4) *Mortality tables and interest rates used.* For purposes of paragraph (d) (2) and (3) of this section, the net level premium reserve (*R*) and the net single premium (*X* or *Y*) shall be based on the 1958 CSO Mortality Table and 4 percent interest.

(5) *Dividends.* If an insurance policy that meets the requirements of this section provides permanent benefits, part or all of the dividends under the policy may be includible in the employee's income. If the employee pays nothing for the permanent benefits, all dividends under the policy that are actually or constructively received by the employee are includible in the employee's income. In all other cases,

the amount of dividends included in the employee's income is equal to:

$(D+C)-(PI+DI+AP)$

where

D is the total amount of dividends actually or constructively received under the policy by the employee in the current and all preceding taxable years of the employee;

C is the total cost of the permanent benefits for the current and all preceding taxable years of the employee determined under the formulas in paragraph (d) (2) and (6) of this section:

PI is the total amount of premium included in the employee's income under paragraph (d)(1) of this section for the current and all preceding taxable years of the employee;

DI is the total amount of dividends included in the employee's income under this paragraph (d)(5) in all preceding taxable years of the employee; and

AP is the total amount paid for permanent benefits by the employee in the current and all preceding taxable years of the employee.

(6) *Different policy and taxable years.* (i) If a policy year begins in one employee taxable year and ends in another employee taxable year, the cost of the permanent benefits, determined under the formula in paragraph (d)(2) of this section, is allocated between the employee taxable years.

(ii) The cost of permanent benefits for a policy year is allocated first to the employee taxable year in which the policy year begins. The cost of permanent benefits allocated to that policy year is equal to:

$F \times C$

where

F is the fraction of the premium for that policy year that is paid on or before the last day of the employee taxable year; and

C is the cost of permanent benefits for the policy year determined under the formula in paragraph (d)(2) of this section.

(iii) Any part of the cost of permanent benefits that is not allocated to the employee taxable year in which the policy year begins is allocated to the subsequent employee taxable year.

(iv) The cost of permanent benefits for an employee taxable year is the sum of the costs of permanent benefits allocated to that year under paragraph (d)(6) (ii) and (iii) of this section.

(7) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. An employer provides insurance to employee A under a policy that meets the requirements of this section. Under the policy, A, who is 47 years old, received $70,000 of group-term life insurance and elects to receive a permanent benefit under the policy. A pays $2 for each $1,000 of group-term life insurance through payroll deductions and the employer pays the remainder of the premium for the group-term life insurance. The employer also pays one half of the premium specified in the policy for the permanent benefit. A pays the other half of the premium for the permanent benefit through payroll deductions. The policy specifies that the annual premium paid for the permanent benefit is $300. However, the amount of premium allocated to the permanent benefit by the formula in paragraph (d)(2) of this section is $350. A is a calendar year taxpayer; the policy year begins January 1. In year 2000, $200 is includible in A's income because of insurance provided by the employer. This amount is computed as follows:

(1) Cost of permanent benefits	$350
(2) Amounts considered paid by A for permanent benefits (1/2 × $300)	150
(3) Line (1) minus line (2)	200
(4) Cost of $70,000 of group-term life insurance under Table I of §1.79-3	126
(5) Cost of $50,000 of group-term life insurance under Table I of §1.79-3	90
(6) Cost of group-term insurance in excess of $50,000 (line (4) minus line(5))	36
(7) Amount considered paid by A for group-term life insurance (70 × $2)	140
(8) Line (6) minus line (7) (but not less than 0)	0
(9) Amount includible in income (line (3) plus line (8))	200

(e) *What is the effect of State law limits?* Section 79 does not apply to life insurance in excess of the limits under applicable state law on the amount of life insurance that can be provided to an employee under a single contract of group-term life insurance.

(f) *Cross references.* (1) See section 79(b) and §1.79-2 for rules relating to group-term life insurance provided to certain retired individuals.

(2) See section 61(a) and the regulations thereunder for rules relating to life insurance not meeting the requirements of section 79, this section, or §1.79-2, such as insurance provided on the life of a non-employee (for example, an employee's spouse), insurance not provided as compensation for personal services performed as an employee, insurance not provided under a policy carried directly or indirectly by the employer, or permanent benefits.

(3) See sections 106 and §1.106-1 for rules relating to certain insurance that does not provide general death benefits, such as travel insurance or accident and health insurance (including amounts payable under a double indemnity clause or rider).

(g) [Reserved]

(h) *Effective date.* Section 1.79-0 applies to insurance provided in employee taxable years beginning on or after January 1, 1977 (except as provided in 26 CFR 1.79-1(g) (revised as of April 1, 1983) with respect to insurance provided in employee taxable years beginning in 1977). Sections 1.79-1 through 1.79-3 apply to insurance provided in employee taxable years beginning after December 31, 1982. See 26 CFR 1.79-1 through 1.79-3 (revised as of April 1, 1983) for rules applicable to insurance provided in employee taxable years beginning before January 1, 1983.

(Secs. 79(c) and 7805 of the Internal Revenue Code of 1954 (78 Stat. 36, 26 U.S.C. 79(c); 68A Stat. 917, 26 U.S.C. 7805))

[T.D. 7623, 44 FR 28797, May 17, 1979, as amended by T.D. 7917, 48 FR 45762, Oct. 7, 1983; T.D. 7924, 48 FR 54595, Dec. 6, 1983; T.D. 8821, 64 FR 29790, June 3, 1999; T.D. 9223, 70 FR 50971, Aug. 29, 2005]

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For questions concerning e-CFR programming and delivery issues, email webteam@gpo.gov.

Power79 Plan℠

Background notes for accounting professionals regarding The Section 79 Program known as the Power79.

As background information . . . The following is the paper trail to our discussion of this Section 79—permanent benefit program for small and medium sized business owners.

The original research including our law firm's legal fees and Treasury Department expense to bring this program into compliance exceeded $155,000 and took almost a year to complete.

Greenberg-Traurig of New York, is one of the largest tax law firms in America. The tax chair for the firm, Jeffrey D. Mamorsky, J.D., L.LM., is our tax attorney. He worked with us and the U.S. Treasury Department to recreate this program and update it. Mr. Mamorsky is also well known in the U.S. legal community as the attorney who wrote the final draft of legislation for the U.S. Congress that we call ERISA. Any attorney who becomes an ERISA attorney or tax attorney must study the work of Mr. Mamorsky to obtain the additional credentials.

Once the above process was completed we applied to the U.S. Copyright office for a copyright on this program. We update that copyright annually.

The insurance company who sponsors the actual product required an extensive review process to vet the program as well:

Program reviewed & approved by:

In-house legal counsel
Outside independent legal counsel
Chief Actuary (**level 4 actuary**)
Advanced Designs attorneys
Advanced Underwriting attorneys
Chief Compliance attorney
and finally 2 hours of CPE credit for CPAs

Why, because since 1985 CPAs do not receive any formal training on 'Permanent Benefit" Section 79.

We have had 8 audits since 2000, all triggered by <u>other</u> activity of the taxpayer. All deductions requested were allowed to stand as applied for.

And finally . . . we can now show it to you.

Section 5

Greenberg Traurig– Mamorsky Legal Opinion Letter
RSM McGladrey Wealth Wisdom Article
AICPA Wealth Management Insider Article

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May 8, 2000

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Alpine, Utah 84004

Gentlemen::

You have asked us, under the facts and circumstances described below, (1) whether a group of individual life insurance policies provided to a group of individual employees that otherwise meets the requirements under Section 79 of the Internal Revenue Code ("Code" or "IRC") constitute "group term life insurance" within the meaning of Section 79 of the Code; (2) whether group-term life insurance which otherwise qualifies under Section 79 of the Code continues to meet the Code's definition of group-term life insurance if the employer offering the insurance allows employees who would otherwise receive more than $50,000 of insurance to elect to reduce their coverage to a lesser amount, but in no case less than $50,000; (3) whether a group-term life insurance plan which otherwise qualifies under Section 79 may provide term insurance which contains permanent benefits (as described below); and (4) whether an employee insured under a life insurance policy containing permanent benefits, in addition to group-term benefits qualifying under Section 79, may reduce the amount includible in the employee's income each tax year by the amount the employee pays for the permanent benefits.

FACTS

You have advised us that the Business Planning Group, Inc. has developed a group-term life insurance plan which it proposes to offer to various employers (hereinafter referred to as the "Plan"). All insurance policies provided to employees under each Plan would qualify as life insurance contracts for federal income tax purposes, within the meaning of Code Section 7702 and each Plan is intended to qualify under Section 79 of the Code. Separate individual policies may be written on the life of each employee eligible to participate in an employer's Plan. Paid up life insurance and life insurance with cash value (collectively, the "Permanent Benefits") also may be provided under an employer's Plan. All payments made to the insurer by an employee with respect to any Permanent Benefits contained in an insurance policy on the life of the employee will be actually paid by the employee with after-tax dollars. Moreover, no employee insured under a term life insurance policy containing Permanent Benefits will be allowed to withdraw all or any portion of the paid-up cash value of such policy until he has retired from employment with the sponsoring employer or until the sponsoring employer has terminated its Plan.

We shall assume that any Plan that provides Permanent Benefits to employees will satisfy all requirements necessary for the Plan to qualify as a group-term life insurance plan under Section 79 of the Code, including, without limitation, the requirements of Sections 1.79-1(b)(1) and (2) of the Treasury Regulations ("Regulations").

Specifically, to the extent a term insurance policy provided under an employer's Plan contains Permanent Benefits, the policy or employer will designate in writing what part of the death benefit provided to the employee is group-term insurance and what part is Permanent Benefits. Furthermore, the part of the death benefit that is provided to an employee and designated as the group-term life insurance benefit for any policy year will not be less than the difference between the total death benefit provided under the policy and the employee's deemed death benefit at the end of the policy year determined in accordance with Sections 1.79-1(b) and (d)(3) of the Regulations.

Generally, the amount paid by the employer on account of premiums for group-term life insurance covering its employees under an arrangement as described above are deductible as an ordinary expense under Section 162 of the Code. Also, death benefits paid to the beneficiary designated by the employee under an arrangement as described above generally do not constitute taxable income to the beneficiary when those benefits are paid under Section 101(a) of the Code.

CONCLUSIONS AND ANALYSIS

I. Individual Policies as a Group Policy

Section 1.79-0 of the Regulations provides that the term "policy" includes two or more obligations of an insurer which are sold in "conjunction" as a result of being offered or made available to members of a group of employees because of the employment relationship. The Regulations specifically provide that multiple obligations may be sold in "conjunction" even if the obligations are in separate documents or even if each document is independent of any other obligation. In this regard, the Regulations emphasize that a group of individual contracts under which life insurance is provided to a group of employees may be a group policy for Section 79 purposes.

Therefore, in our opinion, there is substantial authority for the position that a group of individual life insurance obligations (policies) provided to a group of employees constitutes a group-term policy for the purposes of Section 79 of the Code.

II. Reduction of Group-Term Life Insurance Coverage

The Regulations provide that in order to qualify as group-term life insurance for purpose of Section 79, the amount of insurance provided to each employee must be computed under a formula (i) based on factors such as age, years of service, compensation or position and (ii) that precludes individual selection (the "individual selection" requirement). *See* Regulations 1.79-1(a)(4). The Regulations point out, however, that the individual selection requirement may be satisfied even if the amount of insurance provided is determined under a limited number of alternative schedules that are based on the amount each employee elects to contribute.

Also, the IRS has ruled that a provision in a group-term life insurance plan which permits an employee to voluntarily reduce his insurance coverage will not cause the insurance provided under the plan to fail to meet the individual selection requirement so long as: (1) the amount of insurance available to employees under the plan is based on a formula that is uniform as to compensation, (2) the Company will not individually select particular persons to receive an extra or reduced amount of insurance, and (3) coverage will not be reduced below $50,000. *See* Priv. Ltr. Rul. 9701027 (Oct. 1, 1996) and Priv. Ltr. Rul. 9319026 (Feb. 11, 1993). In both of these rulings, the Plan was amended to permit an employee whose coverage under the Plan would otherwise exceed $50,000 to elect to reduce the amount of that coverage either (i) by multiples of $10,000; (ii) by multiples of 10 percent of the employee's highest eligible compensation; or (iii) to exactly $50,000. An employee was required to make a written election in order to reduce coverage and would not be able to reduce coverage below $50,000.

In addition, the IRS has concluded that the rules of Section 79 apply to determine the taxation of life insurance benefits provided to employees under an employer's "group life carve-out program." Under this program, any employee who has a minimum of five years of service and has a salary of at least $50,000 could waive coverage above $50,000 for which he or she was entitled under the basic plan and replace such excess coverage under the "carve-out" program with an individual permanent life insurance policy. See IRS National Office Technical Advice Memorandum ("TAM") 200002047, 9/30/99. In so concluding, the IRS emphasized that the fact that the insurance is provided under individual policies does not disqualify the insurance from being provided to a group of employees.

Therefore, in our opinion, there is substantial authority for the position that insurance which otherwise qualifies as group-term life insurance will continue to meet the Code's definition of group-term life insurance even if the employees covered by the plan may elect to reduce their plan coverage pursuant to a formula based on some multiple of pay (e.g., 1, 1½, 2, 3 times pay, etc.) or to limit coverage (e.g., in even multiples such as $10,000). However, an employee whose earnings are $50,000 or more cannot reduce coverage below $50,000.

III. Code Section 79 Group-Term Life Insurance And Permanent Benefits

Insurance that otherwise qualifies as group-term life insurance frequently is combined with certain other benefits. The term "permanent benefit" refers to an economic value provided under a life insurance policy with value extending beyond one policy year. See Regulation §1.79-0. The following features are not treated as permanent benefits:

a. A right to convert (or continue) life insurance after group life insurance coverage terminates;

b. Any other feature that provides no economic benefit (other than current life insurance protection) to the employee; or

c. A feature under which term life insurance is provided at a level premium for a period of five years or less. Id.

However, the Regulations provide that a paid-up or cash surrender value are examples of a "permanent benefit" which may be provided to employees under a group-term life insurance policy. Also, it is important to emphasize that the Regulations specifically provide that two benefits provided to a group of employees, one term life insurance and the other a permanent benefit, qualify as a group policy under Section 79 and the Regulations even if one of the benefits is provided only to employees who decline the other benefit. Id.

Therefore, in our opinion, there is substantial authority for the position that a plan qualifying under Section 79 of the Code may provide term life insurance to employees which contains permanent benefits.

IV. Federal Income Taxation of Permanent Benefits to Employees

Employees generally are taxed on the cost of that portion of the group-term life insurance paid by the employer to the extent it exceeds the cost of $50,000 of coverage plus any amount paid by the employer toward the purchase of the insurance. IRC § 79(a). This taxable cost is determined by reference to a table (known as Table I) in the Section 79 regulations and not on the actual cost of the coverage (which could be either more or less than the Table I cost).

However, the employee also is taxed on the cost of any permanent benefits paid for by the employer where a qualifying group term life insurance policy provides both term life insurance and permanent benefits. As discussed below, an employee is required to include in his or her income the cost of the permanent benefits reduced by the amount, if any, the employee paid for the permanent benefits. Regulation §1.79-1(d)(1).

A. Cost of Permanent Benefits

During each tax year, the cost of the permanent benefits provided to an employee must be no less than the product of the net single premium for one dollar of paid-up whole-life insurance at the employee's attained age at the beginning of the policy year multiplied by the increase in the employee's deemed death benefit during the policy year. Regulation §1.79-1(d)(2).

The net single premium for one dollar of paid-up whole-life insurance is determined by using the 1958 Commissioner's Standard Ordinary ("CSO") Mortality Table and a 4% interest rate. Regulation §1.79-1(d)(4). The deemed death benefit at the end of a policy year is determined by dividing: (i) the greater of the cash value of the policy at the end of the policy year, or the net level premium reserved at the end of the policy year for all benefits provided to the employee by the policy; by (ii) the net single premium for one dollar of paid-up whole-life insurance at the employee's age at the end of the policy year. Regulation §1.79-1(d)(3). Both the net level premium reserve and the net single premium discussed above are determined by using the 1958 CSO Mortality Table and a 4% Interest rate. Regulation §1.79-1(d)(4).

B. Treatment of Dividends under Policies with Permanent Benefits

In addition to the amount determined under Part IV A. above, an employee insured under a participating group permanent policy qualifying under Section 79 may have all or part of the dividends paid or made available to the employee under the policy includible in gross income. Regulation §1.79-1(d)(5). If the employee pays nothing for the permanent benefits, all dividends actually or constructively received by the employee under the policy are includible in gross income.

However, where an employee insured under a qualifying group permanent product pays part of the cost of permanent benefits provided under the policy, only part of the dividends paid to the employee, actually or constructively, are includible in gross income. The portion of the dividends includible in the employee's gross income is determined pursuant to a formula set forth in Regulation §1.79-1(d)(5).

V. Substantial Understatement Penalty Should Not Apply

The Code provides a civil penalty of 20% for a substantial understatement of tax. The penalty does not apply if there is substantial authority for the tax treatment of the item in question or if the relevant facts affecting the item are adequately disclosed in the taxpayer's tax return and there is a reasonable basis for the tax treatment. As described above, at parts I through IV, there is substantial authority,[1] predominantly in the form of Treasury Regulations and bolstered by the analysis set forth in two private letter rulings, supporting the qualification of the life insurance policies in question under Section 79 of the Code. See, Regulation §§1.6662-4(d)(2) and 1.6662-4(d)(3)(ii).

If the understatement of tax of an individual is derived from a tax shelter, different rules for avoiding the penalty apply. However, to be subject to these rules, there must first be an entity, investment plan or arrangement which has a significant purpose of tax avoidance or evasion. Although the life insurance described herein is an investment plan, other plan or arrangement, there is no tax avoidance or evasion purpose in structuring the insurance plan to qualify with section 79 of the Code. Even if the plan were a tax shelter within the meaning of the Code, it would not be subject to penalty because there is substantial authority for the tax treatment of the item and the tax treatment is more likely than not the proper treatment. Regulation §1.6662-4(g)(1)(i).

If you have any questions regarding the above, please do not hesitate to contact me.00000000000000000000000000000000

Sincerely,

Jeffrey D. Mamorsky

JDM/la

379881

[1] We have found no authorities contrary to the position in the Regulations which would be taken into account in weighing the authorities for this position.

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Jeff concentrates his practice in the areas of compensation and employee benefits law. He serves as employee benefits counsel to Fortune 100 corporations, governmental agencies, Big Five accounting firms, leading employee benefits consulting firms, and major multi-employer pension and welfare funds. Mr. Mamorsky's publications have been cited on numerous occasions by the U.S. Supreme Court and other federal and state courts. In addition, he lectures widely on ERISA and employee benefits. Additionally, Jeff was one of the drafters of the ERISA law and subsequent governmental regulations thereunder.

AREAS OF EXPERIENCE

- Employee benefits and compensation
- IRS' Employee Plans Examination Program
- Non-qualified employee benefits programs
- Managed care agreements and related service provider agreements
- Welfare and pension plans
- Employment discrimination issues
- COBRA

KEY CLIENTS

- Montefiore Medical Center
- National Education Association
- 1199 National Benefit & Pension Funds for Hospital and Healthcare Employees
- Severance Trust Executive Plan (STEP)
- Health Services Retirement Plan (HSRP)
- Marsh & McLennan
- Hudson News Company
- The VEBA Corporation
- Stinnes Corporation
- RAG International Trading

SIGNIFICANT REPRESENTATIONS

- Evaluation, design and drafting of qualified and non-qualified employee benefits programs, current and deferred executive compensation arrangements, innovative tax-efficient vehicles for investment by corporate and not-for-profit plan sponsors, such as the Severance Trust Executive Program ("STEP") and Health Services Severance Plan ("HSSP"), and welfare benefits plans, including cost-effective medical programs such as cafeteria plans, flexible spending arrangements, managed care programs and third-party administration contracts.

- Advice in connection with qualifying plans under the Internal Revenue Code and operational compliance with the Code's coverage and nondiscrimination requirements, including compliance with the IRS Voluntary Compliance Resolution

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("VCR") Program, Administrative Policy Regarding Self-Correction ("APRSC") and Employee Plans Closing Agreement Program ("CAP").

- Counsel to the Marsh & McLennan Mergers & Acquisitions Qualified Plan Review Insurance Program ("QPRI") which provides assurance that a retirement plan has been operated in accordance with the terms of the plan document and IRS rules by requiring a Fiduciary Audit® Review of plan operations performed by the department as a condition of obtaining QPRI coverage which indemnifies the plan sponsor for any monetary sanctions imposed by IRS.

- Counsel to the underwriters at Lloyds London Qualified Plan Insurance ("QPI") Program which insures a plan and plan sponsor employer and board of trustees (in the case of a multi-employer plan) against IRS liability (e.g., CAP monetary sanctions) resulting from operational defects in a qualified plan not identified by the Fiduciary Audit® Annual Report which the department prepares as counsel to the QPI Program

- Assistance in performing due diligence with respect to compliance of compensation and benefits programs with ERISA and related provisions of the Internal Revenue Code for corporate mergers and acquisitions through the Fiduciary Audit® Operational Review.

- Assisting welfare benefits plans in statutory and regulatory compliance, including the fiduciary and prohibited transaction requirements of ERISA, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and state legislation such as the New York Health Care Reform Act of 1996.

- Evaluation of Health Care Plan Compliance under ERISA and the Internal Revenue Code ("IRC") through a Fiduciary Audit® Operational Review conducted by members of the department, including review and/or negotiation of written health care plan documents under ERISA, insurance policies, third party administration agreements, analysis of ERISA fiduciary liabilities under such agreements, filing of required government forms for annual returns; qualification of voluntary employee beneficiary associations and cafeteria plans under the IRC and compliance with various rules under health care legislation and regulations (e.g., COBRA and HIPAA).

- Preparation of a cost-effective single plan document and summary plan description for all welfare benefit plans sponsored by an employer or trustees (in the case of a multiemployer plan) that incorporates whatever documentation the insurer or administrator provides, meets all compliance requirements under all applicable federal laws (ERISA, COBRA, IRC, FMLA, HIPAA and USERRA, etc.) and includes all required notices to employees and enrollment forms that are easily readable, user friendly and do not require annual review.

- Advice with respect to negotiation of managed care agreements and related service provider agreements for welfare and pension plans.

- Advice regarding compliance with the fiduciary responsibility requirements of ERISA and the obtaining of prohibited transaction exemptions from the U.S. Department of Labor.

Advice regarding the taxation of employee benefits and compensation programs

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- Advice with respect to compliance of employee benefit plans with federal and state laws relating to employment discrimination and COBRA.

- Assistance in the planning and implementation of effective employee benefits and compensation communication programs.

- Assistance in the design of efficient record-keeping systems that reflect all operative legal documents and that have the capability to handle the complex documentation necessary for fiduciary compliance and ERISA.

- Preparation of comprehensive annual evaluations of employee benefit plan operational compliance with ERISA and related Internal Revenue Code provisions for prototype plan sponsors such as insurance companies and money managers, plan administrators and trustees, corporate plan sponsors, hospitals and other not-for-profit corporations, and boards of trustees of multi-employer plans to limit CAP monetary sanctions and ERISA fiduciary liability and to obtain a VCR Compliance Statement from the IRS on qualified plan operations.

- Advice with respect to plan terminations pursuant to PBGC rules for "standard" and "distress" terminations; satisfaction of PBGC requirements for certain underfunded plans; and negotiation with the PBGC with regard to threatened termination of plan due to breakup of a controlled group sponsor of an underfunded plan.

- Assistance in evaluating the appropriateness of terminating overfunded, defined benefit pension plans to recover excess assets and in securing governmental approvals and designing suitable replacement plans.

- Advice in connection with withdrawals from multi-employer and the triggering of partial and complete withdrawal liability; responding to demands for payments of withdrawal liability and providing representation in arbitration proceedings.

PROFESSIONAL AND COMMUNITY INVOLVEMENT
- Member, Association of the Bar of the City of New York
- American Bar Association, Committee on Pension and Profit-Sharing Trusts
- New York State Bar Association, Committee on Employee Benefits of the Tax Section
- U.S. Chamber of Commerce, Employee Benefits Committee
- Member, American Employee Benefits Institute

ARTICLES, PUBLICATIONS AND LECTURES
- Author, *Pension and Profit Sharing Plans: A Basic Guide*, Executive Enterprises Publications Co.
- Author, *Employee Benefits Law: ERISA and Beyond*, Law Journal Seminars-Press
- Founder and editor-in-chief, *Journal of Compensation and Benefits*
- Editor and contributing author, *Employee Benefits Handbook*
- Editor and contributing author, *Health Care Benefits Handbook*
- Frequent lecturer on ERISA and employee benefits

AWARDS & RECOGNITION
- Chairman of the Healthcare Committee and Vice-Chair of the Tax Committee of the Republican National Lawyers Association

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EDUCATION

- LL.M., Taxation, New York University School of Law, 1975
- J.D., New York University, 1972
- B.A., New York University, 1967

ADMITTED TO PRACTICE

- New York

EMPLOYEE BENEFITS HANDBOOK

VOLUME 2

Editor
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Third Quarter 2007

Retaining key employees: New rules, challenges and opportunities

Attracting and retaining top talent is more difficult than ever. But providing retirement benefit flexibility through a deferred compensation plan is proving an effective incentive to continued employment.

A new tax law dealing with a popular deferred compensation concept can help employers design and install a plan that offers executives tax advantages and flexibility. The new tax rules apply to existing deferred compensation plans.

Abuse in executive benefits led Congress to enact Section 409A of the Internal Revenue Code (IRC) in late 2004. This section, which the IRS has further clarified with comprehensive regulations in 2007, brings certainty and predictability to deferred compensation plans for executives.

With this certainty, however, comes mandatory compliance by the end of this year — and Congress has created sizeable penalties for failure to abide by the rules. If employers have plans that aren't compliant with the new law, executives may be subject to taxes of 70 percent or more. Professional advisors generally agree that the certainty for penalties is warranted and leads to increased use of the deferred compensation technique.

Under these tax rules, employers choose who to cover, for how much, and when to vest and pay out the benefit. The law largely avoids regulating how companies back up or finance commitments they make to their executives. Companies can still use popular funding vehicles, like corporate-owned life insurance and mutual funds, to cover their liability to the employee.

The primary take-away of the new rules is that once the timing of it payout is established, it generally cannot be accelerated. In the event of death, disability, severance of employment or change of corporate control, the benefit must be paid on the agreed-upon date and schedule.

Consider for example, an executive who earns a $100,000 base salary plus a target bonus of $70,000. His or her long-term financial goals include paying for a child's college, building a lake home and preparing for a comfortable retirement. The new tax law allows sufficient flexibility that, under the deferred compensation plan, the executive could choose to defer 20 percent of his or her base pay and 50 percent of the bonus — creating an immediate and sizeable tax savings.

The executive can designate buckets to allocate the deferrals with varying payouts. In this example, the executive allocates 40 percent of the deferrals to a college fund, which begins payout in 2009 over four annual installments. Another 20 percent is allocated to a lake home account with a lump sum payout in 2015 and the remaining 40 percent is allocated to an account that would begin paying out at the normal retirement date. And because IRC 409A didn't take away the employer's opportunity and obligation to back its promises with appropriate funding, the employer can informally finance its commitment to the executive.

Retaining key employees, continued on page 3

Section 79 as a supplemental planning tool

As employer rules for providing non-qualified supplemental retirement benefits become more stringent, the need to look for non-traditional strategies increases. Recent changes in Internal Revenue Code (IRC) Section 409A regulations and closer scrutiny by the IRS have narrowed the planning possibilities for rewarding key employees and business owners.

Many employers use group term life insurance to provide insurance protection for their employees. Coverage amounts up to $50,000 are paid by the employer and are generally income tax-free to employees.

While group term life insurance provides a death benefit for employees during their employment, it doesn't provide portable life insurance protection. Coverage ceases upon retirement or termination of employment. Additionally, group term life insurance often doesn't meet the needs of owners and highly paid key employees. Limits on coverage amounts and the fact that the life insurance benefit is tied to employment may leave these key people without adequate protection.

Adding a permanent benefit to a group term life insurance program can help employers attract, retain and reward owners and key employees. IRC Section 79 allows a corporation to offer participating employees the ability to own a cash value life insurance policy — such as universal life insurance — as part of the group insurance plan. Including cash value life insurance in the plan allows the corporation to use excess pre-tax profits to potentially provide tax-advantaged benefits to participating employees.

Advantages to the employer:

- Contributions to the plan are 100 percent income tax deductible (to the extent compensation is reasonable under IRC Section 162).
- Requires minimal documentation and reporting requirements.
- No mandatory participation requirements.

Advantages to the employee:

- Income tax-free death benefit that is portable into retirement.
- Tax-deferred cash accumulation.
- Tax-free income in later years.*
- Only 60 percent to 65 percent of contribution is includable in taxable income.
- Numerous benefits and applications, including supplemental retirement income and tax planning, non-qualified deferred compensation plan replacement, executive benefits, and estate tax and liquidity planning.
- Uses the IRS' safe harbor valuation method to calculate the cost of permanent benefits.

Section 79 group permanent plans are primarily designed to benefit owner-employees and non-owner key employees. Any business can adopt a group permanent plan to benefit all employees, including non-owner employees. However, if an owner-employee participates in the plan, the business must be organized as a C corporation. Independent contractors, partners in a partnership, members of an LLC (unless it has elected to be taxed as a C corporation), sole proprietors and owners of more than 2 percent of the stock of a subchapter S corporation aren't permitted to receive any group life insurance benefits under Section 79.

Example:

Goal
- Provide deductions, supplemental retirement income and death benefit.

Facts
- Corporation has nine employees plus the owner.
- Corporation needs to remain an S corporation due to unreasonable compensation issues.
- Owner is responsible for the sales and marketing functions.

Solution
- Establish a new C corporation that provides sales and marketing services to the S corporation.
- Section 79 plan is set up in the new C corporation and includes employees from both corporation.
- Owner has $100,000 premium.
- Total cost for the other employees is $1,565.

As the example illustrates, the Section 79 plan can be designed with minimal costs for rank-and-file employees, while allowing key employees and business owners to develop a supplemental plan.

While Section 79 may not be the right solution for every business to attract, reward and retain key employees, it does offer an alternative to traditional non-qualified deferred compensation arrangements that you and your tax professional may want to review.

**Income tax free distributions from a life insurance policy are achieved by withdrawing to the cost basis (premiums paid) then using policy loans. Loans and withdrawals may generate an income tax liability, reduce available cash value and reduce the death benefit or cause the policy to lapse. This assumes the policy qualifies as life insurance is not a modified endowment contract.*

Laura O'Dea is a director with RSM McGladrey Wealth Management. For more information, contact her at laura.odea@rsmi.com.

Tax tips

Rebalancing your portfolio

Wanting to update your portfolio, but not sure which option to choose? Consider rebalancing.

Rebalancing involves restoring your original asset allocation by shifting funds among asset classes to regain the proportions you first designed.

For instance, let's say your original asset allocation calls for 60 percent in equities, 30 percent in fixed income and 10 percent in cash equivalents. The equity allocation is 20 percent in large cap equities, 20 percent in small cap and 20 percent in international. But after a period of time, your allocation has changed due to market fluctuations: The large cap equities now represent 25 percent; small cap is 30 percent and international remain at 20 percent. However, your fixed income securities are now only 15 percent.

In order to rebalance you would have you sell 5 percent of your large cap and 10 percent of your small cap and purchase more fixed income securities (buy low, sell high). *Note: This example is for illustrative purposes only and doesn't represent the actual returns of any investment or portfolio.*

In rebalancing, there may be transaction costs or tax consequences that need to be considered. Selling some large cap or small cap equities may trigger capital gains tax or possibly redemption fees (for some mutual funds). What can you do?

In many situations, like the above, it's quite likely that not all of the large cap or small cap equities are in gain positions. To minimize the effect of taxes, it may be possible to sell some positions with loss along with positions that are in gain – which offset each other. The offsetting of capital gains with capital losses can be accomplished with different types of investment vehicles (mutual funds, exchange-traded funds and individual shares of stock).

You'll need to know the adjusted tax basis of your investment holdings, sales price and how long you've owned the asset. Long-term capital gains and losses apply only when you have held the investment for more than a year. There are a number of other considerations, such as ordinary investment income, investment expenses, possibly passive income and losses, tax-exempt and tax deferred income that may impact the implementation of rebalancing. Therefore, consult with your financial advisor or tax professional first.

Robert Eichten, CFP®, PFS, is a director with RSM McGladrey Wealth Management. For more information, contact him at robert.eichten@rsmi.com.

Retaining key employees, continued from page 1

In general, employers have until the end of 2007 to bring their plans into compliance with the new law. As mentioned, failure to do so results in the penalties being assessed to the executive — not the employer.

Referring back to the example, say at the time the company is audited, the executive has a $100,000 deferred compensation account. If the employer didn't amend its plan to reflect the new IRC 409A rules, the executive could be subjected to immediate income taxation on the plan plus an interest penalty and a 20 percent penalty tax — even though the executive had no part in setting up or administering the company's deferred compensation plan. These cumulative taxes and penalties can quickly exceed 70 percent of the account.

Despite this, deferred compensation as an executive benefit is still highly effective. The new law allows more flexibility and higher limits than traditional qualified plans and these deferred plans often have advantages over other executive benefits, such as stock options and restricted stock. The key for an employer is to review any existing deferred compensation plans for compliance this year. Then focus on creating a flexible — yet manageable — plan design, securing appropriate informal funding for the benefit, and establishing effective administration and ongoing plan monitoring.

Raymond L. Bening, president of Bening Financial, works as an insurance consultant with RSM McGladrey.

Steve Parrish, JD, CLU, ChFC, RHU, national advanced solutions consultant with Principal Life Insurance, works with RSM McGladrey.

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Wealth Wisdom

Inside this issue:

RSM McGladrey

Editor: Julia L. Ramirez

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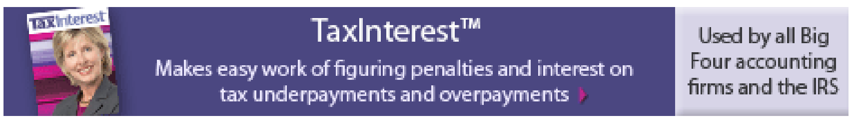

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- National Conference on Divorce
  5/6 – 5/7, Las Vegas, NV
- See Full Conferences Calendar

AICPA Webcasts

- **1/27 -** XBRL — Preparing for Phase II and Detailed Tagging
- **1/27 -** Sources and Proper Uses of Available Data
- **1/28 -** Closing the Privacy GAPP: Best Practices to Protect Your Data
- See Full Web Events Calendar

Resources

Igor Zey

Modern Section 79 Plans

Tax beneficial retirement planning for business owners.

January 21, 2010
by Igor Zey, CLU/ChFC

Executive compensation planning opportunities for closely held businesses have been greatly curtailed during the past decade. Nonqualified and some “supercharged” pension plans used to offer a wide variety of customized supplemental plans to address reverse discrimination limitation endemic to traditional ERISA plans. These plans were mainly covered in my previous article. Regulatory and legislative activity of the past 10 years all but decimated those planning opportunities either by outright prohibition on some or entwining others with unbearable rules and restrictions, even making some into “listed transactions” (419 plans and 412(i) plans). Split dollar plans used to be attractive in the context of retirement planning and provided a wide variety of supplemental income opportunities. Together with other types of non-qualified plans legislative and regulatory activism severely curtailed viability of those plans for most clients.

Unfortunately for the planning industry, “new and improved” often meant “more complicated and convoluted,” quite aggressive and often structurally and economically unsound.

Advisors and their clients generally want economically sound, straightforward, simple and effective strategies and ideas. One plan from the past that is going through a revival of sorts is the IRC Section 79 group term life plan.

The cost of these plans is 100-percent deductible to the corporation as an ordinary and necessary business expense under Section 162(a). However, a portion of the plan contribution must be reported as income by the participating employee. Due to certain recent changes in reporting requirements, the reportable portion has gone from 40 percent to 50 percent from 10 years to 15 years ago to a current 60 percent to 65 percent. Notwithstanding this increase, many advisors, CPAs and Employee Retirement Income Security Act (ERISA) attorneys find appreciable value in the planning opportunities presented by Section 79 Plans, particularly their ease of implementation, simplicity of design and absence of potentially harmful legislative complications.

Section 79 plans derive from the Internal Revenue Code’s section setting forth rules for employer-sponsored group life, health and medical insurance benefits. As it relates to life insurance, an employer may provide up to $50,000 of group term life insurance for its employees without any cost to the employee (Section 79(a)(1)). The corporation will receive a tax deduction for the premiums paid and the employee does not report any income. If the benefit exceeds $50,000, it is still fully deductible by the corporation, but the employee must pick up the Table I charge (Treas. Reg. Sec. 1.79-3(d)(2)) on excess death benefit every year the plan is in existence.

The attractiveness of the plan lies in the ability of the employer to provide inexpensive tax deductible fringe benefit at no cost to the employees. Employees also have the option to increase their benefits based on the plan formula and pick up corresponding taxable income and highly compensated key employees will find those benefits highly advantageous.

Those additional benefits may be funded with permanent or term insurance based on employees' choice (Treas. Reg. Sec. 1.79-1(b) and Treas. Reg. Sec. 1.79-1(c)(5)). Based on the safe harbor valuation found in Rev. Proc. 2005-25, between 60-65% of premiums paid are taxable to the employee, while the corporation deducts the full amount. The choice of policy is very important and actuarial review is highly recommended.

Clients are able to set up a plan to accumulate substantial, potentially larger than qualified plans, pools of tax-deferred assets that could be used up during their lifetime on a tax-free basis via policy loans under Sec. 72(e)(4)(A). In addition, clients acquire generally needed life insurance protection and may shelter assets from the claims of creditors. It is important to note that creditor protection laws are state specific, however proper advanced planning will accomplish desired results with respect to creditor protection issues. Anyone contemplating an asset protection plan should not undertake such without the advice of legal counsel.

Case Study

Dr. I.M. Surgeon, 49-years old, owns and operates several surgical centers through a "C" management corporation. His salary is around $500,000. He considered but chose not to set up a defined benefit (DB) plan, because the cost of providing comparable benefits to his 30 full-time employees was far greater than any potential tax and accumulation benefits for him. Dr. Surgeon would like to supplement his existing 401(k)/profit-sharing plan and create additional current tax deductions.

The Section 79 Plan for Dr. Surgeon is based on his determination to set aside additional $250,000 per year for himself for five years.

Annual Year	**Funding**	**Deductible Contribution by Corporation**	**W-2 Income to Executive**	**Net Cost in 40% Tax Bracket**
1	250,000	250,000	162,156	64,862
2	250,000	250,000	161,245	64,498
3	250,000	250,000	155,995	62,398
4	250,000	250,000	151,055	60,422
5	250,000	250,000	146,255	58,502
Total:		**1,250,000**	**776,706**	**310,682**

The funding stops after the fifth year and the insurance policy continues to accumulate cash value until age 65 or other desired retirement date. The original death benefit is $4,720,000; it is reduced after year seven to minimize insurance costs and maximize accumulations (not required).

Assuming retirement income starts at 65, the policy will provide:

Annual Income Tax-Free Retirement Distribution **174,245**

Annual Taxable Equivalent	**290,408** 20 x Years (Age 65-84)
Total 20-Years Tax-Free Retirement Distributions	**$3,484,900**
Total 20-Years Taxable Equivalent – Taxable equivalent from a qualified plan in a 40-percent tax bracket	**$5,808,160**

Over time, the policy's actual non-guaranteed elements and perhaps actual use of the policy's options are likely to vary from the assumptions used in this chart. For these reasons, actual policy performance will either be more or less favorable than shown.

The benefits of the plan are easier to appreciate by comparison. Simplicity of design is comparable to an executive bonus plan, commonly known as Section 162 Bonus plan. The Section 79 Plan offers everything that a Section162 Bonus plan offers and provides a client with about 35 percent to 40 percent of his bonus tax free. Additionally, there are no complications with transfer of interest in the policy, trust(s) creation and administration, vesting schedules and other lapsing restrictions.

Another and probably more effective way to illustrate the relative benefits of the Section 79 plan is to liken it to a ***partially deductible Roth IRA***. A Roth IRA, simply put, is an “after-tax-contribution, tax-free-growth, tax-free-distribution” strategy. A Section 79 plan, by way of comparison, is a “partially-tax-deductible-contribution, tax-free-growth, tax-free-distribution.”

In effect, the plan allows your clients to capture the best of both qualified and nonqualified plans!

Conclusion

A Section 79 plan would benefit clients:

- For whom a Defined Benefits plan has little appeal due to “non-discrimination costs” and, thus, fail to address adequately their retirement needs
- Who have maxed out on their 401(k) contributions
- Who need and want additional corporate tax deductions
- Who operate as a C-Corporation

A Section 79 Plan cannot be established for an S-corporation because of the pass-through nature of the entity. As a result, IRC Sec. 264(a)(1) disallows a deduction for premiums paid on a life insurance policy by a taxpayer when that taxpayer is directly or indirectly a beneficiary of the policy. Thus, C-corporations are the only entities able to deduct the premiums paid on group term insurance on the life of an owner as an ordinary and necessary business expense under Section 162(a). Since many clients operate as “S” corporations, it may be possible to establish a second company, such as a management corporation, assuming that the general business structure allows for such an arrangement. Since the benefits of the Sec. 79 plan will be offered to all employees of both companies anyway, there should be no concern with affiliated service group status.

END

Section 6	Section 79 Code Explanation of the valuation for “Permanent Benefits Table 1 Rates

the employment relationship. The actuarial sufficiency of the premium charged for each obligation is not taken into account in determining whether the obligations are sold in conjunction. In addition, obligations may be sold in conjunction even if the obligations are contained in separate documents, each document is filed with and approved by the applicable state insurance commission, or each obligation is independent of any other obligation. Thus, a group of individual contracts under which life insurance is provided to a group of employees may be a policy. Similarly, two benefits provided to a group of employees, one term life insurance and the other a permanent benefit, may be a policy, even if one of the benefits is provided only to employees who decline the other benefit. However, an employer may elect to treat two or more obligations each of which provides no permanent benefits as separate policies if the premiums are properly allocated among such policies. An employer also may elect to treat an obligation which provides permanent benefits as a separate policy if—

(a) The insurer sells the obligation directly to the employee who pays the full cost thereof;

(b) The participation of the employer with respect to sales of the obligation to employees is limited to selection of the insurer and the type of coverage and to sales assistance activities such as providing employee lists to the insurer, permitting the insurer to use the employer's premises for solicitation, and collecting premiums through payroll deduction;

(c) The insurer sells the obligation on the same terms and in substantial amounts to individuals who do not purchase (and whose employers do not purchase) any other obligation from the insurer; and

(d) No employer-provided benefit is conditioned on purchase of the obligation.

[T.D. 7623, 44 FR 28797, May 17, 1979, as amended by T.D. 7917, 48 FR 45762, Oct. 7, 1983]

§ 1.79–1 Group-term life insurance—general rules.

(a) *What is group-term life insurance?* Life insurance is not group-term life insurance for purposes of section 79 unless it meets the following conditions:

(1) It provides a general death benefit that is excludable from gross income under section 101(a).

(2) It is provided to a group of employees.

(3) It is provided under a policy carried directly or indirectly by the employer.

(4) The amount of insurance provided to each employee is computed under a formula that precludes individual selection. This formula must be based on factors such as age, years of service, compensation, or position. This condition may be satisfied even if the amount of insurance provided is determined under a limited number of alternative schedules that are based on the amount each employee elects to contribute. However, the amount of insurance provided under each schedule must be computed under a formula that precludes individual selection.

(b) *May group-term life insurance be combined with other benefits?* No part of the life insurance provided under a policy that provides a permanent benefit is group-term life insurance unless—

(1) The policy or the employer designates in writing the part of the death benefit provided to each employee that is group-term life insurance; and

(2) The part of the death benefit that is provided to an employee and designated as the group-term life insurance benefit for any policy year is not less than the difference between the total death benefit provided under the policy and the employee's deemed death benefit (DDB) at the end of the policy year determined under paragraph (d)(3) of this section.

(c) *May a group include fewer than 10 employees?* (1) As a general rule, life insurance provided to a group of employees cannot qualify as group-term life insurance for purposes of section 79 unless, at some time during the calendar year, it is provided to at least 10 full-time employees who are members of the group of employees. For purposes of this rule, all life insurance provided under policies carried directly or indirectly by the employer is taken into account in determining the number of employees to whom life insurance is provided.

(2) The general rule of paragraph (c)(1) of this section does not apply if the following conditions are met:

(i) The insurance is provided to all full-time employees of the employer or, if evidence of insurability affects eligibility, to all full-time employees who provide evidence of insurability satisfactory to the insurer.

(ii) The amount of insurance provided is computed either as a uniform percentage of compensation or on the basis of coverage brackets established by the insurer. However, the amount computed under either method may be reduced in the case of employees who do not provide evidence of insurability satisfactory to the insurer. In general, no bracket may exceed 2½ times the next lower bracket and the lowest bracket must be at least 10 percent of the highest bracket. However, the insurer may establish a separate schedule of coverage brackets for employees who are over age 65, but no bracket in the over-65 schedule may exceed 2½ times the next lower bracket and the lowest bracket in the over-65 schedule must be at least 10 percent of the highest bracket in the basic schedule.

(iii) Evidence of insurability affecting employee's eligibility for insurance or the amount of insurance provided to that employee is limited to a medical questionnaire completed by the employee that does not require a physical examination.

(3) The general rule of paragraph (c)(1) of this section does not apply if the following conditions are met:

(i) The insurance is provided under a common plan to the employees of two or more unrelated employers.

(ii) The insurance is restricted to, but mandatory for, all employees of the employer who belong to or are represented by an organization (such as a union) that carries on substantial activities in addition to obtaining insurance.

(iii) Evidence of insurability does not affect an employee's eligibility for insurance or the amount of insurance provided to that employee.

(4) For purposes of paragraph (c) (2) and (3) of this section, employees are not taken into account if they are denied insurance for the following reasons:

(i) They are not eligible for insurance under the terms of the policy because they have not been employed for a waiting period, specified in the policy, which does not exceed six months.

(ii) They are part-time employees. Employees whose customary employment is for not more than 20 hours in any week, or 5 months in any calendar year, are presumed to be part-time employees.

(iii) They have reached the age of 65.

(5) For purposes of paragraph (c) (1) and (2) of this section, insurance is considered to be provided to an employee who elects not to receive insurance unless, in order to receive the insurance, the employee is required to contribute to the cost of benefits other than term life insurance. Thus, if an employee could receive term life insurance by contributing to its cost, the employee is taken into account in determining whether the insurance is provided to 10 or more employees even if such employee elects not to receive the insurance. However, an employee who must contribute to the cost of permanent benefits to obtain term life insurance is not taken into account in determining whether the term life insurance is provided to 10 or more employees unless the term life insurance is actually provided to such employee.

(d) *How much must an employee receiving permanent benefits include in income?*—(1) *In general.* If an insurance policy that meets the requirements of this section provides permanent benefits to an employee, the cost of the permanent benefits reduced by the amount paid for permanent benefits by the employee is included in the employee's income. The cost of the permanent benefits is determined under the formula in paragraph (d)(2) of this section.

(2) *Formula for determining cost of the permanent benefits.* In each policy year the cost of the permanent benefits for any particular employee must be no less than:

$$X(\mathrm{DDB}_2 - \mathrm{DDB}_1)$$

where

DDB_2 is the employee's deemed death benefit at the end of the policy year:

DDB_1 is the employee's deemed death benefit at the end of the preceding policy year; and

X is the net single premium for insurance (the premium for one dollar of paid-up whole-life insurance) at the employee's attained age at the beginning of the policy year.

(3) *Formula for determining deemed death benefit.* The deemed death benefit (DDB) at the end of any policy year for any particular employee is equal to—

$$R/Y$$

Where—

R is the net level premium reserve at the end of that policy year for all benefits provided to the employee by the policy or, if greater, the fair market value of the policy at the end of that policy year; and

Y is the net single premium for insurance (the premium for one dollar of paid-up, whole life insurance) at the employee's age at the end of that policy year.

(4) *Mortality tables and interest rates used.* For purposes of paragraph (d) (2) and (3) of this section, the net level premium reserve (*R*) and the net single premium (*X* or *Y*) shall be based on the 1958 CSO Mortality Table and 4 percent interest.

(5) *Dividends.* If an insurance policy that meets the requirements of this section provides permanent benefits, part or all of the dividends under the policy may be includible in the employee's income. If the employee pays nothing for the permanent benefits, all dividends under the policy that are actually or constructively received by the employee are includible in the employee's income. In all other cases, the amount of dividends included in the employee's income is equal to:

$$(D+C)-(PI+DI+AP)$$

where

D is the total amount of dividends actually or constructively received under the policy by the employee in the current and all preceding taxable years of the employee;

C is the total cost of the permanent benefits for the current and all preceding taxable years of the employee determined under the formulas in paragraph (d) (2) and (6) of this section:

PI is the total amount of premium included in the employee's income under paragraph (d)(1) of this section for the current and all preceding taxable years of the employee;

DI is the total amount of dividends included in the employee's income under this paragraph (d)(5) in all preceding taxable years of the employee; and

AP is the total amount paid for permanent benefits by the employee in the current and all preceding taxable years of the employee.

(6) *Different policy and taxable years.* (i) If a policy year begins in one employee taxable year and ends in another employee taxable year, the cost of the permanent benefits, determined under the formula in paragraph (d)(2) of this section, is allocated between the employee taxable years.

(ii) The cost of permanent benefits for a policy year is allocated first to the employee taxable year in which the policy year begins. The cost of permanent benefits allocated to that policy year is equal to:

$$F \times C$$

where

F is the fraction of the premium for that policy year that is paid on or before the last day of the employee taxable year; and

C is the cost of permanent benefits for the policy year determined under the formula in paragraph (d)(2) of this section.

(iii) Any part of the cost of permanent benefits that is not allocated to the employee taxable year in which the policy year begins is allocated to the subsequent employee taxable year.

(iv) The cost of permanent benefits for an employee taxable year is the sum of the costs of permanent benefits allocated to that year under paragraph (d)(6) (ii) and (iii) of this section.

(7) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. An employer provides insurance to employee A under a policy that meets the requirements of this section. Under the policy, A, who is 47 years old, received $70,000 of group-term life insurance and elects to receive a permanent benefit under the policy. A pays $2 for each $1,000 of group-term life insurance through payroll deductions and the employer pays the remainder of the premium for the group-term life insurance. The employer also pays one half of the premium specified in the policy for the permanent benefit. A pays the other half of the premium for the permanent benefit through payroll deductions. The policy specifies that the annual premium paid for the permanent benefit is $300. However, the amount of premium allocated to the permanent benefit by the formula in paragraph (d)(2) of this section is $350. A is a calendar year taxpayer; the policy year begins January 1. In year 2000, $200 is includible in A's income because of insurance provided by the employer. This amount is computed as follows:

(1) Cost of permanent benefits	$350
(2) Amounts considered paid by A for permanent benefits (½ × $300)	150
(3) Line (1) minus line (2)	200
(4) Cost of $70,000 of group-term life insurance under Table I of §1.79–3	126
(5) Cost of $50,000 of group-term life insurance under Table I of §1.79–3	90
(6) Cost of group-term insurance in excess of $50,000 (line (4) minus line(5))	36
(7) Amount considered paid by A for group-term life insurance (70 × $2)	140
(8) Line (6) minus line (7) (but not less than 0)	0
(9) Amount includible in income (line (3) plus line (8))	200

(e) *What is the effect of State law limits?* Section 79 does not apply to life insurance in excess of the limits under applicable state law on the amount of life insurance that can be provided to an employee under a single contract of group-term life insurance.

(f) *Cross references.* (1) See section 79(b) and §1.79–2 for rules relating to group-term life insurance provided to certain retired individuals.

(2) See section 61(a) and the regulations thereunder for rules relating to life insurance not meeting the requirements of section 79, this section, or §1.79–2, such as insurance provided on the life of a non-employee (for example, an employee's spouse), insurance not provided as compensation for personal services performed as an employee, insurance not provided under a policy carried directly or indirectly by the employer, or permanent benefits.

(3) See sections 106 and §1.106–1 for rules relating to certain insurance that does not provide general death benefits, such as travel insurance or accident and health insurance (including amounts payable under a double indemnity clause or rider).

(g) [Reserved]

(h) *Effective date.* Section 1.79–0 applies to insurance provided in employee taxable years beginning on or after January 1, 1977 (except as provided in 26 CFR 1.79–1(g) (revised as of April 1, 1983) with respect to insurance provided in employee taxable years beginning in 1977). Sections 1.79–1 through 1.79–3 apply to insurance provided in employee taxable years beginning after December 31, 1982. See 26 CFR 1.79–1 through 1.79–3 (revised as of April 1, 1983) for rules applicable to insurance provided in employee taxable years beginning before January 1, 1983.

(Secs. 79(c) and 7805 of the Internal Revenue Code of 1954 (78 Stat. 36, 26 U.S.C. 79(c); 68A Stat. 917, 26 U.S.C. 7805))

[T.D. 7623, 44 FR 28797, May 17, 1979, as amended by T.D. 7917, 48 FR 45762, Oct. 7, 1983; T.D. 7924, 48 FR 54595, Dec. 6, 1983; T.D. 8821, 64 FR 29790, June 3, 1999; T.D. 9223, 70 FR 50971, Aug. 29, 2005]

§1.79–2 Exceptions to the rule of inclusion.

(a) *In general.* (1) Section 79(b) provides exceptions for the cost of group-term life insurance provided under certain policies otherwise described in section 79(a). The policy or policies of group-term life insurance which are described in section 79(a) but which qualify for one of the exceptions set forth in section 79(b) are described in paragraphs (b) through (d) of this section. Paragraph (b) of this section discusses the exception provided in section 79(b) (1); paragraph (c) of this section discusses the exception provided in section 79(b)(2); and paragraph (d) of this section discusses the exception provided in section 79(b)(3).

(2)(i) If a policy of group-term life insurance qualifies for an exception provided by section 79(b), then the amount equal to the cost of such insurance is excluded from the application of the provisions of section 79(a).

(ii) If a policy, or portion of a policy of group-term life insurance qualifies for an exception provided by section 79(b), the amount (if any) paid by the employee toward the purchase of such insurance is not to be taken into account as an amount referred to in section 79 (a)(2). In the case of a policy or policies of group-term life insurance which qualify for an exception provided by section 79(b) (1) or (3), the amount paid by the employee which is not to be taken into account as an amount referred to in section 79(a) (2) is the amount paid by the employee for the particular policy or policies of group-term life insurance which qualify for

How to explain the valuation for "Permanent Benefits"

The following is a description of how permanent benefits associated with a group life insurance plan are valued for income tax purposes.

Permanent Benefits:

First off, let's define what a permanent benefit is; a permanent benefit, as per the Regulations, is an economic benefit extending beyond one policy year. Examples of permanent benefits would include but are not limited to life insurance policy cash values, paid-up life insurance, term life policies with a level premium that extends beyond five years, and any other feature that provides an economic benefit apart from pure protection.

The following brief will give you a solvent communication track to use when explaining the important aspects of permanent benefits as they are expressed in Treasury Regulation 1.79-1. It is important to have a basic handle on this subject, particularly when it comes to the inevitable CPA meeting.

Below you will see an actual copy of the Regulations specific to permanent benefits, and a suggested dialog that's provided in the column to the right.

(b) *May group-term life insurance be combined with other benefits?* No part of the life insurance provided under a policy that provides a permanent benefit is group-term life insurance unless—

(1) The policy or the employer designates in writing the part of the death benefit provided to each employee that is group-term life insurance; and

(2) The part of the death benefit that is provided to an employee and designated as the group-term life insurance benefit for any policy year is not less than the difference between the total death benefit provided under the policy and the employee's deemed death benefit (DDB) at the end of the policy year determined under paragraph (d)(3) of this section.

(d) *How much must an employee receiving permanent benefits include in income?—*

Comment [GN1]: The "unless" simply means that for the plan or policy to qualify as "group term life", the coverage amount is in writing, and is not less than the difference between the "total policy death benefit" minus the "deemed death benefit". In other words, there's no attempt to "understate" the level of coverage that's taxable as imputed income under Table I.

Comment [GN2]: The entire value of the permanent benefit(s) are taxable in the year they are received. And the formula to determine this amount is found right below in 1.79(d)(2).

How to explain the valuation for "Permanent Benefits"

(1) *In general*. If an insurance policy that meets the requirements of this section provides permanent benefits to an employee, the cost of the permanent benefits reduced by the amount paid for permanent benefits by the employee is included in the employee's income. The cost of the permanent benefits is determined under the formula in paragraph (d)(2) of this section.

(2) *Formula for determining cost of the permanent benefits*. In each policy year the cost of the permanent benefits for any particular employee must be no less than: $X(DDB_2 - DDB1)$

where

DDB2 is the employee's deemed death benefit at the end of the policy year:
DDB1 is the employee's deemed death benefit at the end of the preceding policy year; and
X is the net single premium for insurance (the premium for one dollar of paid-up whole-life insurance) at the employee's attained age at the beginning of the policy year.

(3) *Formula for determining deemed death benefit*. The deemed death benefit (DDB) at the end of any policy year for any particular employee is equal to—
R/Y

Where—

R is the net level premium reserve at the end of that policy year for all benefits provided

Comment [GN3]: The deemed death benefit is determined by taking the greater of the net level premium reserve, or the fair market value of the applicable insurance policy, and then ascertain the amount of paid-up insurance under the 1958 CSO one dollar of paid-up life insurance table, adjusted by an interest factor of 4%. As valuations rise in subsequent years, we simply use the higher valuation of the two, to buy paid-up coverage as before, and subtract the previous paid-up coverage level from the prior year to determine the current year's deemed death Benefit. We then convert the value, again under the same 1958 CSO table, to a premium amount, which becomes the permanent benefit value for the current tax year. This value is what's taxable for receiving the permanent benefit(s).

Comment [GN4]: See Comment GN3 above.

Comment [GN5]: The net level premium reserve is an actuarial specific reserve based on an issue age and a specific policy duration.

How to explain the valuation for "Permanent Benefits"

to the employee by the policy or, if greater,
the fair market value of the policy at
the end of that policy year; and
Y is the net single premium for insurance
(the premium for one dollar of paid-up,
whole life insurance) at the employee's age
at the end of that policy year.

(4) *Mortality tables and interest rates used*. For purposes of paragraph (d) (2) and (3) of this section, the net level premium reserve (*R*) and the net single premium (*X* or *Y*) shall be based on the 1958 CSO Mortality Table and 4 percent interest.

(5) *Dividends*. If an insurance policy that meets the requirements of this section provides permanent benefits, part or all of the dividends under the policy may be includible in the employee's income. If the employee pays nothing for the permanent benefits, all dividends under the policy that are actually or constructively received by the employee are includible in the employee's income. In all other cases, the amount of dividends included in the employee's income is equal to:
$(D+C) - (PI+DI+AP)$

Comment [GN6]: Our permanent benefit policy does not include or pay dividends, and therefore, this section is not applicable. Policies that do pay dividends, such as a participating whole life insurance policy, pay their policy owner(s) excess returns above their policy's guaranteed interest rate, in the form of a dividend vs. having a "current interest rate" that exceeds a "guaranteed interest rate".

where
D is the total amount of dividends actually or constructively received under the policy by the employee in the current and all preceding taxable years of the employee;
C is the total cost of the permanent benefits for the current and all preceding taxable years of the employee determined under the formulas in paragraph (d) (2) and (6) of

How to explain the valuation for "Permanent Benefits"

this section:
PI is the total amount of premium included in the employee's income under paragraph (d)(1) of this section for the current and all preceding taxable years of the employee;

benefit is $300. However, the amount of premium allocated to the permanent benefit by the formula in paragraph (d)(2) of this section is $350. A is a calendar year taxpayer; the policy year begins January 1. In year 2000, $200 is includible in A's income because of insurance provided by the employer. This amount is computed as follows:

(1) Cost of permanent benefits $350
(2) Amounts considered paid by A for permanent benefits (1⁄2 · $300) 150
(3) Line (1) minus line (2) 200
(4) Cost of $70,000 of group-term life insurance under Table I of § 1.79–3 126
(5) Cost of $50,000 of group-term life insurance under Table I of § 1.79–3 90
(6) Cost of group-term insurance in excess of $50,000 (line (4) minus line(5)) 36
(7) Amount considered paid by A for group-term life insurance (70 · $2) 140
(8) Line (6) minus line (7) (but not less than 0) 0
(9) Amount includible in income (line (3) plus line (8)) 200

Group Term Life Insurance

An employee is not taxed on premiums paid by an employer under a group term plan meeting the requirements of IRC Sec. 79, unless the amount of coverage exceeds $50,000. If the coverage exceeds $50,000, the employer must compute the cost of the additional protection, and notify the employee of the amount to include in his or her gross income. The government's Table I is used to determine the tax-reportable cost of the excess insurance protection. See Reg. Sec. 1.79-3(d)(2).

Age	Cost per Thousand per Month
Under Age 25	$0.05
25 through 29	0.06
30 through 34	0.08
35 through 39	0.09
40 through 44	0.10
45 through 49	0.15
50 through 54	0.23
55 through 59	0.43
60 through 64	0.66
65 through 69	1.27
70 and over	2.06

Example: A 44-year-old employee has $150,000 of employer-paid group term:

Total Insurance	$150,000
Less: 1st $50,000	- 50,000 (not reportable)
Taxable Amount	$100,000 X $.10 per thousand

Result: The employee must report as income an extra $10 per month, or $120 per year.

The premiums are tax deductible by the corporation under IRC Sec. 162(a)(1).

If a group term plan is discriminatory with regard to benefits or eligibility to participate, the $50,000 income tax exclusion will not be available to key employees. For discriminatory plans, the amount of imputed income is the greater of actual cost or the IRS Table I cost. See IRC Sec. 79(d). Payments for group term insurance which are included in the employee's income are also subject to FICA taxes. See IRC Sec. 3121(a).

Should an employer not be able to meet these rules, consideration should be given to personally-owned insurance as a supplement or substitute for existing employer plans.

Section 7 National Life Technical Guide

National Life Group®

Section 79 Technical Guide

Helping business owner clients provide tax advantaged benefits.

National Life Insurance Company®
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Most small business owners and professional advisors are somewhat familiar with group term life insurance programs – particularly those that offer up to $50,000 of term life insurance to employees. These programs, sanctioned by Section 79 of the Internal Revenue Code, also permit employers to provide additional amounts of term life insurance in excess of $50,000 to employees.

What is less commonly known is that the same Section 79 permits a group term insurance plan to provide *permanent benefits*. Treasury Regulations §1.79-0 defines a "permanent benefit" as "an economic value extending beyond one policy year (for example, a paid-up or cash surrender value) that is provided under a life insurance policy."

When a compliant Section 79 plan containing permanent benefits is adopted by an employer, there are several significant advantages:

- All contributions to the plan are generally 100% deductible to the business.
- Only a portion of these amounts is includible in the participant's income.
- Plan assets (in the form of life insurance policy cash values) accumulate tax-deferred.
- In the event of the participant's death, an income tax-free survivor benefit is provided.[1]
- Benefits can be structured to avoid estate taxes.
- Once the plan is terminated, the participant has all of the rights accorded to a policyowner under the life insurance contract, including the option of receiving an income stream from the insurance policy to the extent of the policy's cash value through the use of tax-free policy loans and withdrawals.[2]

The purpose of this Technical Guide is to explain how a Section 79 plan offering permanent benefits works, discuss its legal underpinnings, and answer some of the more common questions that professional advisors tend to ask.

Brief History

Although group term life insurance had existed long before, Section 79 was added to the Internal Revenue Code in 1964 by Section 204(a)(1) of Public Law 88-272. For the first time, group term insurance provided by the employer became taxable to employees, to the extent that the death benefit exceeded $50,000. In other words, the purpose of Section 79 was not to create an exclusion for premiums paid on $50,000 of insurance. Prior to its enactment **all** employer-paid group-term insurance premiums were excludible. Section 79 was apparently intended as a loophole-closing response to increasingly larger group-term policies being issued on corporate executives.[3] Subsections (a)-(c) were part of the original legislation, and haven't changed materially since that time.[4] Subsection (d), dealing primarily with nondiscrimination rules, was added by TEFRA in 1982, while subsection (e) was added by TRA 1984.

Much of the law governing Section 79 has been created by the Department of the Treasury, including the Internal Revenue Service. The rates for measuring the value of group term insurance protection in excess of $50,000 were established by Regulation §1-79-3(d)(2), as directed by Congress in §79(c), under what is popularly known as Table I. They have been updated several times to reflect improved mortality experience. Regulations have also been used extensively to flesh out the definition and interpretation of what is otherwise a very concise statute. Of special interest are the rules governing the taxation of permanent benefits and the parameters for groups of fewer than 10 employees, of which there is absolutely no mention in the statute itself. The IRS has also issued occasional Revenue Rulings and other pronouncements that help define the boundaries of the law under Section 79.

An important example of the *de facto* legislative power of Treasury involved the issuance of a series of pronouncements (beginning with Proposed Regulations in 2004) culminating in Treasury Decision 9223 on August 29, 2005, which amended the Regulations

1 Internal Revenue Code § 101(a)(1). There are some exceptions to this rule.

2 Policy loans and withdrawals reduce the policy's cash value and death benefit and may result in a taxable event. Withdrawals up to the basis paid into the contract and loans thereafter will not create an immediate taxable event, but substantial tax ramifications could result upon contract lapse or surrender. Surrender charges may reduce the policy's cash value in early years.

3 See Current Individual Life Insurance Topics, Record of Society of Actuaries, 1976 Vol. 2 No.2, at p. 305.

4 It is interesting to note that, according the CPI Inflation Calculator provided by the DOL Bureau of Labor Statistics, $50,000 in 1964 has the equivalent purchasing power of $365,195 in 2011.

under Section 79 in one small way: by substituting the words "fair market value" for the words "cash value" – that had been in Regs. §1.79-1(d)(3) since its inception – the value of "permanent benefits" subject to taxation was effectively doubled. See Rev. Proc. 2005-25 for an expanded discussion of "fair market value."

Section 79 plans were "hot" from an insurance industry marketing perspective in the 1970's and early 1980's. In part this was due to a strategy called Retired Lives Reserves (RLR), where employers would take large current deductions to fund reserves to provide post-retirement insurance protection to employees. Employer contributions were not currently taxable to employees, and would not be taxable to the extent that the employees continued to receive post retirement protection. Often, there was no intention actually to continue insurance protection after the employee retired and the "reserves" could be raided to provide what amounted to tax deductible deferred compensation to owners and key executives. These perceived abuses led to the enactment, in TRA 1984, of Sections 419 and 419A, which limited deductions for such reserves to amounts necessary to fund up to $50,000 of post-retirement protection over the working lives of the participants.

After the enactment of Sections 419 and 419A, the remaining tax advantage seemed paltry in comparison with the halcyon days, and the result was that virtually all the insurance carriers that had been involved in marketing Section 79 permanent benefit products left the marketplace rather suddenly. More than a decade later, someone discovered quite by accident that some products designed specifically for "pension rollout" strategies produced some significant tax benefits under Section 79 plans. Although these benefits might not have been viewed as exciting in 1984, in an environment bereft of many of the tax-advantaged strategies that had gone by the way of the dinosaur since that time, there was renewed interest in Section 79 as a legitimate strategy combining modest tax advantage with life insurance protection.

Nevertheless, other developments continued to suppress insurance carriers' appetite for supporting products that could be effective in Section 79 plans:

- Perceived abuses of welfare benefit plan rules under sections 419 and 419A led the IRS to clamp down on these strategies.
- The same "fair market value" rules that dampened the Section 79 market put a huge dent in strategies centered around "pension rollouts" and "springing cash value" life insurance products.
- A national audit program focused on fully insured 412(i) plans further decreased demand for products that could also be effective in Section 79 plans.
- By the end of 2008 all insurance companies were required to stop selling products that did not use 2001 CSO mortality tables. This meant that if a carrier was going to enter, or remain in, the Section 79 marketplace it would have to manufacture a product specifically for this use.
- As a general rule, a business owner must receive W-2 compensation from a C corporation in order to enjoy all the benefits of a Section 79 plan. Over the past two decades decreasing numbers of closely held businesses have chosen to be organized as C corporations.

The upshot has been that most carriers have decided not to invest scarce resources in products specifically designed for what they view as a boutique market.

What is Group-Term Life Insurance?

Regs. §1-79-1(a) poses this question, and proceeds to answer it in Treasury's inimitable fashion – in the negative. It begins this way:

Life insurance is not group-term life insurance for purposes of section 79 unless it meets the following conditions:

(a)(1) It provides a **general death benefit** that is excludable from gross income under section 101(a).

(a)(2) It is provided to a **group of employees**.

(a)(3) It is provided under a policy **carried directly** or **indirectly by the employer**.

(a)(4) The amount of insurance provided to each employee is computed under a formula, based on factors such as age, years of service, compensation, or position, that **precludes individual selection**.

Regs. §1.79-0 provides some helpful definitions:

"Employee."

§1.79-0 points to Regs. §31.3401(c)-1 for the most important definition of this term. That is the section that speaks to the right of the employer to control and direct both the outcomes of the employee's work and the means the employee uses to accomplish those outcomes, thus distinguishing an "employee" from an independent contractor.

"Group of employees."

Two definitions are provided: (1) "all employees of an employer" or (2) "less than all employees if membership in the group is determined solely on the basis of age, marital status, or factors related to employment," such as membership in a union, job responsibilities, compensation, or length of service.

"Policy."

In addition to the obvious – that insurance can be provided in a single contract – the Regulation defines the term to include "two or more obligations of an insurer that are sold in conjunction." Thus, multiple insurance contracts may be used to fund a single participant's Section 79 benefits.

"Carried directly or indirectly."

The most relevant criterion is that "the employer pays any part of the cost of the life insurance directly or through another person."

"Formula ... that precludes individual selection."

Neither the Code nor the Regulations define what is meant by this requirement. The leading case on this subject is Towne v. Commissioner, 78 T.C. 791 (1982), in which each member of the employee group was entitled to one times compensation, to a maximum of $25,000. Mr. Towne, the President and CEO of the employer, subsequently added a $500,000 term policy to his existing coverage, and the plan was amended to add a second class, of which he was the only member.[5] The Tax Court ruled that the employer was thus "individually selecting that one particular person receive an extra amount of insurance."

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5 The story behind this case was that Mr. Towne was not in particularly good health and had been rated 300% on his large insurance purchase. What he was after was the exclusion for the cost of the first $50,000 (actually, an additional $25,000 over and above the initial $25,000 policy), plus use of the Table I rates to measure the taxable cost of insurance in excess of $50,000, which was significantly less than the actual cost of the insurance.

Special Rules for Groups of Fewer Than 10 Employees

§1.79-1(c(1)) of the Treasury Regulations states the **general rule** that *"life insurance provided to a group of employees cannot qualify as group-term life insurance for purposes of section 79 unless, at some time during the calendar year, it is provided to at least 10 full-time employees who are members of the group of employees."*

The Regulation goes on to describe three conditions which, if met, constitute an exception to the general rule, thus allowing groups of fewer than 10 to qualify under Section 79.

1. "The insurance is **provided to all full-time employees** of the employer ... who provide evidence of insurability satisfactory to the insurer." [§1.79-1(c)(2)(i)]
2. The amount of insurance provided is computed either as a **uniform percentage of compensation** or on the basis of coverage brackets established by the insurer." [§1.79-1(c)(2)(ii)]
3. "Evidence of insurability affecting an employee's eligibility for insurance or the amount of insurance provided to that employee is limited to a medical questionnaire completed by the employee that **does not require a physical examination**." [§1.79-1(c)(2)(iii)]

There is nothing in the Internal Revenue Code that makes a distinction between groups of different sizes, and so there is no legislative history to consult. Why the Regulations make this distinction is not clear. What Treasury was thinking, and/or what the underlying objective or public policy consideration might be is unknown.

In determining whether the first condition is met, employees may be excluded if they have not been employed for six months; or if they are part-time or seasonal; or if they have reached the age of 65. [§1.79-1(c)(4)]

The second condition is generally not an issue, since in most plans (including those with 10 or more participants) the amount of life insurance benefit offered is based on a uniform multiple of compensation, as suggested under §79(d)(5).

The third condition is the most troublesome, since it may artificially limit the coverage otherwise available to an employee as well as exclude the employee from receiving the most favorable underwriting classifications.

National Life Group approach

Although National Life Group companies provide permanent life insurance policies for use in Section 79 plans, they act solely as a product provider. Various Third Party Administrators (TPAs) have designed their own plans, and clients must rely on their own advisors for tax and legal advice. Nonetheless, National Life Group insists that certain minimum precautions be taken to avoid unnecessary audit or financial risks for clients. In the arena of groups of fewer than 10 employees, National Life Group requires the following:

- Required evidence of insurability is limited to medical questions that may be asked through telephone interviews and/or in writing.
- The "best" underwriting classification that is available under this process is "standard."
- A flat extra cost of insurance is charged for the first 5 policy years.
- The amount of coverage will be limited to the company's remaining retention limits with respect to an individual insured.

Exceptions
Although additional evidence of insurability is not required, certain exceptions are *allowed*:

1. If there exists a convertible term life insurance policy issued by any National Life Group company that has been in force for at least one year, National Life Group will allow the conversion to a permanent policy based on the underwriting classification and up to the face amount of the term policy.
2. Medical underwriting information obtained by Life Insurance Company of the Southwest (LSW) or National Life (NL) in conjunction with a prior bona fide application that resulted in a policy being issued and taken may be used in applying for a Section 79 permanent policy.

The C Corporation Requirement

A Section 79 plan may be adopted in any form of entity, and otherwise eligible rank and file employees may always participate. Generally speaking, however, owners of the business – including 2% shareholders of an S corporation – may participate only if they receive W-2 income from a C corporation, or from an LLC that elects to be taxed as a C corporation.

The source of this restriction begins with the definition of "group-term life insurance" under Regs. §1.79-1(a)(2), discussed earlier, which provides that the plan is for a group of *employees*, as that term is defined under Section 3401 and its accompanying regulations.

- **Sole proprietors and partners are self-employed, and are not considered employees**. The same applies to members of an LLC that elects to be taxed as a partnership.
- Guaranteed payments to partners are "considered as made to one who is not a member of the partnership," but only for purposes of §61(a) and §162(a). [§707(c)] This does not bring partners within the definition of "employee."
- Under §1372, those owning more than 2% of the value or voting power of an S corporation **("2% Shareholders") are considered to be partners – not employees – for employee fringe benefit purposes**. This is true if they are 2% owners for as brief a time as a single day in the S corporation's tax year.

Many businesses are or can legitimately be organized using multiple entities of different types. For example, an owner of an S corporation may also be a W-2 employee of a C corporation, which may or may not be affiliated with the S corporation.

Establishing a C corporation

If a C corporation does not already exist in the client's business model, it may make sense to (1) convert the existing entity into a C corporation or (2) add a C corporation to the business model. The first option requires no discussion here: that is a matter that the clients should discuss with their tax advisors on an ongoing basis, independently of Section 79 considerations.

Establishing a C corporation may be considered if there is a valid business purpose for the new entity and the entire transaction is conducted in a business-like manner.

Examples:

- A company that manufactures and sells products establishes a C corporation to handle the sales and marketing functions.
- An ophthalmology practice sets up a C corporation to handle the optometry function.
- A large property and casualty insurance agency establishes a C corporation to handle the agency's internal management and administration functions.
- A consulting company organized as an LLC has 5 major clients. The principals decide to set up a C corporation to handle client #5.

On the other hand, sham transactions should be avoided.

Example
A medical practice, organized as an S corporation, is owned by 12 doctors. They want to set up a management company organized as a C corporation so that the doctors can participate in a Section 79 plan. However, only one physician actually performs management functions. This would appear to be a sham with respect to the other 11 physicians, who cannot legitimately be paid for management services they do not perform.

A primary purpose of a newly established C corporation should be to **allow owners to participate – not to exclude rank and file** employees of the pass-through entity. Although the affiliated service group and controlled group sections of the Code do not explicitly apply to the Section 79 nondiscrimination rules, National Life Group feels strongly that employers should behave as though they do apply and that plans should be as inclusive as possible with respect to rank and file employees.

Practical considerations

Assume that the owner of an S corporation decides to establish a C corporation so that she can participate in a Section 79 plan. If the C corporation's only source of income is going to be fees for services provided to the S corporation, then the first consideration is making sure that the fees paid are reasonable in light of the services provided. Secondly, those fees should be able to support enough base compensation so that the multiple of compensation that must be offered to all participants (to determine the face amount of insurance) stays within reasonable limits. In addition, there has to be enough cash flow in the C corp to pay the Section 79 contribution as well as the employer's share of Social Security taxes, worker's compensation premiums, and other employer expenses. A major Section 79 TPA recommends that base compensation be a minimum of 37-40% of the intended contribution. On the other hand, some practitioners believe that since the plan contribution is itself W-2 compensation, the intended plan contribution can be used in part to determine the multiple. This is somewhat of a chicken/egg issue on which the law appears to be silent.

Keep in mind that Section 79 plans may be established in sole proprietorships and business entities other than C corporations for employees other than the owners who are ineligible for reasons described above.

What's the Appeal of Section 79?

A Section 79 plan using an appropriately designed product allows a participant to enjoy what amounts to an income tax "discount" on a permanent life insurance policy, which can provide the participant with needed insurance protection as well as the potential to access the cash value using tax-free policy loans and withdrawals.

Example

Marvin Johnson owns a successful property and casualty insurance agency that does business as a C corporation. His annual W-2 income is $350,000. Marvin is 43 years old, in excellent health, and has a wife and 3 young children. He has only a small amount of life insurance to protect his family if he should die prematurely. Marvin would like to have his company contribute $100,000 per year for five consecutive years to a Section 79 plan, which will be sufficient to purchase about $2.2 million dollars of permanent life insurance on his life.

Here's what the plan might look like with respect to Marvin:

- The corporation will contribute and deduct $100,000 each year for five consecutive years.
- **Marvin will have to include, on the average, only about $62,000 in income** in connection with each of those contributions. This includes an amount representing the value of insurance protection in excess of $50,000 as well as the value of the permanent benefits provided by the policy. Thus, a primary source of appeal is in the **employee tax exclusion** rather than the corporate deduction: after all, *any* ordinary and necessary business expense – including compensation – is deductible. This means that a Section 79 plan can be used effectively with a low tax bracket, or even tax-exempt, employer.
- In addition to the insurance protection, the policy illustration projects[6] a cash value of nearly $800,000 at Marvin's age 60, to which he is looking forward as a possible early retirement date.
- Based on non-guaranteed elements of the policy illustration, Marvin could elect to take over $100,000 per year from the cash value of the policy using tax-free loans and withdrawals, beginning at age 61 and continuing for 20 years.[7]

It's Not That Simple! There are Rules!

Of course, there are a variety of rules that must be taken into account for all this to work smoothly for Marvin. Here's how they work:

Corporate deduction

The ability to deduct these amounts assumes that they constitute "reasonable compensation" under §162(a)(1). It also assumes that the corporation is not a direct or indirect beneficiary under the policy, as provided in §264(a)(2).

$50,000 exclusion

§79(a) of the Code provides an exclusion from an employee's income for the "cost" of $50,000 of group-term life insurance. However, pursuant to §79(b), the exclusion is not available if any of the following apply:

- The employee has terminated employment and is disabled as defined in §72(m)(3)

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6 This example is purely hypothetical and for illustrative purposes only. The example shown above does not represent the actual results of any particular policy. Actual results may be more or less favorable.

7 Policy loans and withdrawals reduce the policy's cash value and death benefit and may result in a taxable event. Withdrawals up to the basis paid into the contract and loans thereafter will not create an immediate taxable event, but substantial tax ramifications could result upon contract lapse or surrender. Surrender charges may reduce the policy's cash value in early years. Riders may be available to prevent a policy from lapsing due to accessing the cash value of the policy, subject to restrictions and limitations. Riders are optional, may be available at additional cost, and may not be available in all states or on all products.

- The employer is directly or indirectly a beneficiary of the insurance
- A charity is the sole beneficiary of the insurance for the tax year in question
- The insurance protection is provided through a qualified retirement plan

In addition, this **exclusion is not available with respect to key employees if the plan is found to be discriminatory**.

A "**key employee**" is defined with reference to §416(i)(1) of the Code. Basically, this means:

- An officer of the employer having an annual compensation greater than $165,000 (in 2012)
- a 5-percent owner of the employer, or
- a 1-percent owner of the employer having an annual compensation from the employer of more than $150,000.

Cost of insurance

§79(c) provides that the cost of insurance shall be determined under the Treasury Regulations. Treasury has obliged by publishing what is popularly referred to as Table I in Regs. §1.79-3(d)(2). The costs are shown as amounts per $1,000 of protection per month, based on 5-year age brackets.

Value of Permanent Benefits

The formula for valuing permanent benefits is contained in Regs. §1.79-1(d). To understand the formula, it is useful either to be an actuary or to have ready access to one. Insurance carriers and Section 79 Third Party Administrators (TPAs) depend on actuaries to apply the formula to the specific product being used in a particular situation to determine the amount that is properly includible in a participant's income.

Nondiscrimination rules

§79(d) sets forth some rules for determining whether or not a plan is discriminatory, and if it is, what the consequences are. §79(d)(2) provides that a plan may not discriminate in favor of key employees in terms of **eligibility** to participate or as to the **type and amount of benefits** provided.

Eligibility §79(d)(3)(A)

- The plan must benefit at least 70% of employees, **or**
- At least 85% of participants must be non-key employees

For purposes of applying the 70% test, **certain employees may be excluded** from consideration. These include those who have not completed 3 years of service; are part-time or seasonal employees; are members of a collective bargaining unit, if Section 79 benefits were the subject of good faith bargaining; or nonresident aliens with no earned income from sources within the United States. [§79 (d)(3)(B)]

Benefits §79(d)(4)

- The **type** of benefits available to key employees must be available to all participants. Translation: if permanent benefits are available to key employees, they must be offered to rank and file as well.
- Safe harbor for **amount** of benefits: death benefits are based on a uniform multiple of compensation. [§79(d)(5)] Translation: if key employees are offered insurance face amounts equal to 6 times compensation, all participants must be offered 6 times compensation.

In large employee groups, it may be possible to divide the participants into classes, in which certain groups containing key employees may be entitled to higher benefit amounts than other classes.[8]

It must be noted that the nondiscrimination rules do not require the plan to **provide** the same type and amount of benefits to all participants: they must simply be made available. This recognizes the fact that any benefits provided to an employee in excess of $50,000 of group-term insurance will result in additional taxable income to the employee – without additional cash resources to pay the resulting taxes. Thus rank and file employees can, and generally do, in our experience, elect benefits that will not increase their taxable income

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8 The Example under Regs. §1.79-4T, Q & A 9, suggests that one can divide the workforce into groups, and if each group considered separately meets the nondiscrimination tests then the plan as a whole is nondiscriminatory. An example is given where out of 500 participants, 10 of whom are key, 400 non-key EEs receive insurance equal to 100% of compensation, while the group consisting of 90 non-keys and 10 keys receive 200% of compensation. The plan is nondiscriminatory because in the smaller group (the one containing the 10 key employees), more than 85% of that group are non-keys getting the same multiple of compensation.

9 PLR 9701027 and PLR 9319026. These Rulings discussed was more related to individual selection than nondiscrimination.

(i.e., $50,000 of group-term insurance). Two Private Letter Rulings[9] permit employees to reduce the amount of coverage that has been made available to them (1) by multiples of $10,000; (2) by multiples of 10% of their highest eligible compensation; or (3) exactly to $50,000.

Thus, in establishing a Section 79 plan, the Third Party Administrator (TPA) will require a complete census so that it can determine which employees must be considered in applying the eligibility rules and which may be excluded. Each employee is then typically offered 3 choices:

- Insurance with permanent benefits in a face amount calculated based on a multiple of the employee's compensation that is uniform with respect to all participants in the plan.
- Term insurance (that is, without permanent benefits) in a face amount calculated based on a multiple of the employee's compensation that is uniform with respect to all participants in the plan.
- $50,000 of term insurance.

Consequences if plan is determined to be discriminatory.

In the event that a plan is found to be discriminatory, then with respect to key employees,

- The exclusion for the cost of $50,000 of insurance protection is not available, and
- The cost of employer-provided insurance protection is the greater of the Table I amount or the actual cost of insurance. [§79(d)(1)]

Cost of discrimination

National Life Group believes that every plan should be designed and implemented in a nondiscriminatory manner. However, in the event that a plan inadvertently becomes discriminatory, the cost to the key employees should not be particularly onerous.

- For example, the disallowed exclusion amount for a key person age 55-59 is $258 per year. In a 40% tax bracket, the lost exclusion amounts to $103.20.
- The Table I amount is typically greater than the actual cost of insurance, unless the policy carries a significant rating. Thus, for most key employees, the cost of insurance will be no greater than if the plan were nondiscriminatory.

Other questions we have been asked:

Q How many employees are needed to form a "group?" Is two enough? How about one?

A Regs. §1.79-0 defines "group of employees" as "**all employees of an employer**, or less than all employees if membership in the group is determined solely on the basis of age, marital status, or factors related to employment." As cited earlier, the Regulations governing groups of fewer than 10 employees say that the insurance must be "provided to all full-time employees or, if evidence of insurability affects eligibility, to all full-time employees who provide evidence of insurability satisfactory to the insurer." [Regs. §1.79-1(c)(2)(i)] At first blush, it would seem that if a company has only a single employee it would be possible to establish a Section 79 plan with a group of one. However, there is also the requirement under Regs. §1-79-1 (a)(4), discussed earlier, that provides: "The amount of insurance provided to each employee is computed under a formula, based on factors such as age, years of service, compensation, or position, that **precludes individual selection**." Given this additional provision, there would seem to be limited circumstances under which a single employee plan would be viable.

Q Is a Section 79 plan considered an ERISA plan?

A Yes. ERISA §3(1) defines an "employee welfare benefit plan" and "welfare plan" as "any plan, fund, or program which was … established or maintained by an employer … to the extent that such plan, fund, or program was established … for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, … benefits in the event of … death … ."

Q What are the implications of ERISA for Section 79 plans?

A The requirements are minimal, but include the following"

- ERISA §402(a)(1) provides that every employee benefit plan "shall be established and maintained pursuant to a written instrument." Typically this is satisfied by the use of an Adoption Agreement provided by the plan administrator (TPA).

- The same section of ERISA provides that there must be "one or more named fiduciaries who ... have authority to control and manage the operation and administration of the plan." In a Section 79 plan, the TPA serves as the named fiduciary.
- Although §403(a) contains a general rule that "all assets of an employee benefit plan shall be held in trust by one or more trustees," §403(b) contains an exception for "any assets of a plan which consist of insurance contracts or policies issued by an insurance company qualified to do business in a State."

Q How can the death proceeds of a Section 79 policy be excluded from the insured's estate?

A The insured may transfer the policy to an irrevocable life insurance trust (ILIT) or to a third person at any time. Unless the transfer is a "bona fide sale for an adequate and full consideration in money or money's worth," then the insured must live at least three years beyond the transfer date for the proceeds to escape inclusion under Code §2035.

Q What are the gift tax implications of a transfer of the policy?

A Three situations must be considered:

1. *The transfer occurs after the policy is no longer subject to the terms of the plan*, which in most situations is after the 5th policy anniversary. In this case, the gift tax value is determined in the same way as for any personally owned policy. Under Regs. §25.2512-6(a), this would be some acceptable measure of the "replacement value" of the policy, which may not be dissimilar from its "fair market value."

2. *The transfer occurs immediately after the policy is issued*. There are two aspects to this situation. First of all, there is the initial gift of the policy, which under Regs. §25.2512-6(a) would appear to be the premium that was paid. Then there is the question of the annual gifts that occur each year the policy is subject to the terms of the plan. It would seem that the value of the gift from years 2-5 would be the amount that would be included in the participant's income, i.e., the value of the permanent benefit plus the Table I cost. Although there have been no rulings on the gift tax value of a permanent benefit, Rev. Rul. 84-147 supports the use of Table I to determine the gift tax value of the insurance protection.

3. *The transfer occurs during the funding period under the Section 79 plan*. The gift tax value should be determined by using a combination of the principles outlined above: the initial gift of the policy is determined under Regs. §25.2512-6(a), while the ongoing annual imputed gifts are the sum of the value of the permanent benefits and the Table I cost.

Note that the participant continues to be responsible for both income tax and gift tax consequences as long as the policy is subject to the plan.

Q Is the annual gift tax exclusion available for the gifts to the ILIT?

A The trust can be designed to allow for the annual exclusion. *Crummey* letters must be sent in connection with all gifts. As to the initial transfer of the policy, the trustee must have the power to satisfy a withdrawal demand either by withdrawing funds from the policy or by assigning an interest in the policy to the beneficiary, assuming there are no other assets in the trust. A separate transfer to the trust of "seed money," coupled with *Crummey* powers, can provide the trustee with assets to satisfy withdrawal demands, even as to imputed gifts. [PLR 8006109] If the trust provides that the beneficiary is to receive the full proceeds of the policy immediately on the insured's death, at least the value of the insurance protection should qualify for the annual exclusion, even in the absence of *Crummey* powers. [Rev. Rul. 76-490]

Q Can Section 79 insurance be used to fund a buy-sell agreement?

A Section 79 insurance can play a role in buy-sell funding, but caution is required.

- **Entity purchase arrangements**. Making the entity a beneficiary of the insurance is problematical for at least two reasons:
- First, §79(b) negates the exclusion for the cost of $50,000 of term insurance to the extent that "the employer is directly or indirectly the beneficiary" of the insurance policy.
- More importantly, §264(a)(1), provides that no deduction shall be allowed for "premiums on any life insurance policy ... if the taxpayer is directly or indirectly a beneficiary under the policy...."

Thus, to fund an entity purchase arrangement, the proceeds would have to be payable to someone other than the employer, and then transferred to the entity as a loan or capital contribution so that the entity could redeem the insured's interest in the employer company.

- **Cross purchase arrangements**. Assume that two shareholders wish to use their Section 79 policies to fund a cross purchase buy-sell arrangement. Each names the other as beneficiary of the policy he owns on himself. (If there are more than two shareholders, then each would name a trust as beneficiary.) There is no difficulty if the insured shareholders of the C corporation are also partners in a partnership or members of an LLC that has elected to be taxed as a partnership. Otherwise, a significant portion of the death proceeds could be income taxable under the "transfer for value" rule of §101(a)(2).
  - In the absence of a partnership relationship, Section 79 policies can still be used in a buy-sell, but primarily to fund a lifetime buyout.
  - Each shareholder owns the Section 79 insurance policy on his or her own life. The cash values can be used to fund, at least partially, a lifetime buyout of another shareholder's interest.
  - Separate term policies are cross-owned to protect against premature death.

Q **Assuming there is a legitimate business purpose for establishing a C corporation, how much cash flow does the C corporation require?**

A If the C corporation's only source of income is going to be fees for services provided to a pass-through entity, then the first consideration is making sure that the fees paid are reasonable in light of the services provided. That being said, the cash flow issue is more of an art than a science, which must take into account the following cash needs of the C corporation:

- Must pay to each employee a base compensation sufficient to result in a death benefit that is a reasonable (i.e., 15 times or less) multiple of compensation
- An amount necessary to make the plan contribution
- Cash to pay employment taxes related to both base compensation and the plan contribution
- Cash to pay any other business operating expenses

One major TPA has said that in most cases where the C corporation has been established to provide services to a single related company, it will need cash flow of approximately 140% of the annual plan contribution.

Q **How does a Section 79 plan work for an older employees, or for those with health issues?**

A **Older employees.**
The tax benefits drop dramatically as the participant gets much older than 65. Table I rates increase with age, but the primary factor is a significant increase in the value of the permanent benefit. In fact, at certain ages the total includible amount will eventually exceed the actual premium paid. Before this occurs, the most prudent course of action is to terminate the participant's involvement in the plan and complete the funding through some other means.

Rated employees

For participants with health conditions that require a substandard rating, a Section 79 plan can work effectively. An example may serve best to clarify:

Assume that the executive is a male, age 43, on whose behalf the company plans to make a $100,000 annual plan contribution. The executive is shown how the policy will work if the underwriting classification is preferred non-smoker and the policy is designed to produce the lowest death benefit allowable while still avoiding Modified Endowment Contract (MEC) status, which in this case we'll assume to be just over $2.2 million.

The executive goes through the medical underwriting process, which reveals a previously unknown health issue, and the policy that is offered carries a 200% rating. Assume that the same $100,000 premium now buys a minimum death benefit of about $1.9 million. Alternatively, the $2.2M death benefit could be retained by increasing the premium.

Assuming the executive opts for the lower death benefit, his cost of insurance will decrease by about 21% (compared to the preferred illustration), while the value of the permanent benefit would increase somewhat. His average includible income for the 5-year period would be about 6.5% higher than with the preferred rating.

Q **What happens if the employer suffers financial reverses and cannot make the contributions for the full 5-year funding period?**

A The adoption agreement may need to be amended to reflect the changed circumstances, but ultimately the impact is determined by the life insurance policy itself. Any reduction in funding will produce a decrease – perhaps a significant decrease – in the cash value accumulation over time, and thus the income that can be generated by the contract. If the funding reduction is so early or so severe that the policy values are insufficient to sustain the contract, it will lapse without value.

Q **Can the plan be funded beyond 5 years? What if the employer wants to continue funding?**

A The permanent life insurance policies in a Section 79 plan can be funded under the plan until either negative tax leverage occurs (i.e., the taxable amount exceeds the premium) or no more premiums can be paid into the contract, consistent with the legal definition of life insurance under §7702 of the Internal Revenue Code. Generally, if contributions are made as scheduled, negative tax leverage occurs after five annual premiums have been paid, at which time either the plan is terminated or the participant withdraws from the plan. A small amount of additional funding may occur outside the plan after year 5, but the policy is designed to be funded to its legal maximum with something less than 6 premiums.

Employers who wish to continue the program beyond five years may start a new policies in year 6. To guarantee the executive's insurability, convertible term insurance may be purchased at the same time the initial plan is installed. The term insurance may be converted to permanent coverage in year 6 when the new policy funding period begins.

Q **How are Section 79 contributions treated for tax reporting purposes?**

A Contributions are treated differently for various employment taxes:

- Annual reporting requirements for Section 79 plans are found in §6052(a). Under Regs. §1.6052-1 these are satisfied when the employer's Section 79 contributions are included on the employee's W-2 form.
- Boxes 1, 3, 5, and 12 (Code C) of the W-2 are used, although box 3 will not be used if the executive is already above the Social Security wage base.
- §3401(a)(14) excludes from the definition of "wages," for purposes of withholding taxes, "remuneration paid in the form of group-term life insurance on the life of an employee." Thus, an employer is not required to withhold federal income taxes on Section 79 includible amounts.
- §3306(b)(2)(C) excludes from the definition of "wages," for purposes of FUTA, "the amount of any payment (including any amount paid by an employer for insurance ...) made to, or on behalf of, an employee ... under a plan ... established by an employer which makes provision for his employees ...on account of death." Thus, Section 79 payments are not subject to FUTA.
- The employer deduction for Section 79 contributions is taken on line 24 of the corporation's Form 1120.
- Although Internal Revenue Code § 6039D initially required the filing of information returns (Form 5500) for years beginning after December 31, 1988, that requirement was delayed "until the Service provides further guidance," which it has as yet failed to do. [See IRS Notices 90-24 and 2002-24.]

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Section 8 CCH CPA Whitepaper

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KEY FINDINGS FROM THE CCH ACCOUNTING FIRM CLIENT SURVEY

Improving Retention through Better Client Connections

INTRODUCTION

Client retention is the number one concern for CPA firms today. Keeping the right clients satisfied and finding new ways to serve them better must be at the center of a firm's strategy and everyday execution to remain successful and profitable — especially in challenging economic times.

A key component of retention is client satisfaction, and there's no better way to know how well firms are satisfying clients' expectations than to ask the clients themselves. As a strategic partner to tax, accounting and audit professionals, CCH undertook an independent survey of accounting firm clients to help firms gain insight into what's important to clients today. The findings are included in this white paper, which discusses the needs and expectations of accounting firm clients nationwide and what firms can do to achieve greater success.

The results of the *CCH Accounting Firm Client Survey* are promising. Business and individual clients of firms of all sizes value their accountant as a strategic advisor, with the majority satisfied with the services they receive and willing to refer their accountant to another client. And, most clients have stayed with their accounting firm for several years — another very positive sign.

The survey also found, however, that firms may be missing opportunities to serve their current client base and that they can strengthen client connections and become more proactive in addressing client satisfaction in order to increase retention, profitability and growth.

Times have changed. While the need for accounting services surged in the past decade and firms' biggest concerns related to keeping up with that growth, the economic decline of the past three years, as well as other factors, have introduced new pressures on the profession in terms of competition, demand for services, client expectations, value and pricing.

Today, firms are faced with clients who:

- Have more options than ever with whom they do business;
- Are placing new emphasis on pricing and value;
- Have changing needs and whose service expectations are being driven more and more by their other consumer-based experiences;
- Are increasingly being prospected by other firms; and
- Define loyalty more and more by what you've done for them lately.

In fact, despite general satisfaction with their accounting firm, 36 percent of business clients and 19 percent of individual clients report they are likely to switch CPA firms in the next year, according to the *CCH Survey*.

Firms clearly cannot afford that loss. So, what can firms do to improve service, satisfaction, retention and profitability?

Summary Findings

The *CCH Accounting Firm Client Survey* provides direct insight into the client's world: their wants and needs; what drives their decision-making; and what firms need to do, and avoid doing, to win and keep their business.

As noted, results of the survey show both promise and challenge. There are significant opportunities for CPA firms to expand the services and value they offer to clients, and there is growing risk in not doing so.

Key findings of the *CCH Survey* include:

- Clients almost universally recognize their CPA firm as a strategic advisor, and firms have a significant opportunity to better leverage this relationship by providing existing clients with extended services.
- Significant gaps exist between the volume of tax, accounting, auditing and management advisory services clients need and the amount of service in each of these areas they seek from their CPA firm, meaning clients are turning elsewhere for support or doing it themselves.
- Gaps also exist between clients' expectations for performance on key criteria and their firm's actual performance in delivering on these attributes.
- Clients' needs for additional support and specialized services are growing.
- Clients increasingly expect access to the services they want, when and where they want them.

- Retention risks are real. Not only are clients considering switching firms, many also report they are being prospected by other CPA firms.
- The top reason clients would consider leaving their firm is if the firm did not regularly check with them on their changing needs.
- Firms' overall expertise is a top driver in firm selection for business clients. For individuals, referrals most often drive selection.
- Business clients are leveraging technology and they expect their firms to do the same, whether it's working in the cloud or digitizing more of their environment.

The remainder of this white paper provides direct and independent insight into what clients think and want. Firms can put this information into action to strengthen client connections today, as well as leverage and customize suggested survey questions *(see page 23)* to survey their own clients and thereby improve their understanding of client needs and create better client connections.

WHAT CLIENTS WANT

Firms Seen As Valued Advisor

It's clear that clients view their CPA firm as a valued advisor: The majority of both business and individual clients surveyed agreed with the statement that their firm is a strategic advisor compared to simply a service provider who takes direction. *(See Figures 1 and 1a.)*

Firms do, however, have an opportunity to improve in this area by working to ensure that clients are completely confident in their accountant as an advisor. A close look at the results reveal that while 94 percent of businesses and 81 percent of individuals agree that their CPA firm is a strategic advisor – only 19 percent and 27 percent, respectively, completely agree with that assessment. One reason for this may be that firms are not serving a comprehensive range of client needs. The *CCH Survey* found that firms can do more for their clients and that they have the opportunity to leverage this valued-advisor relationship to expand the services they provide to clients.

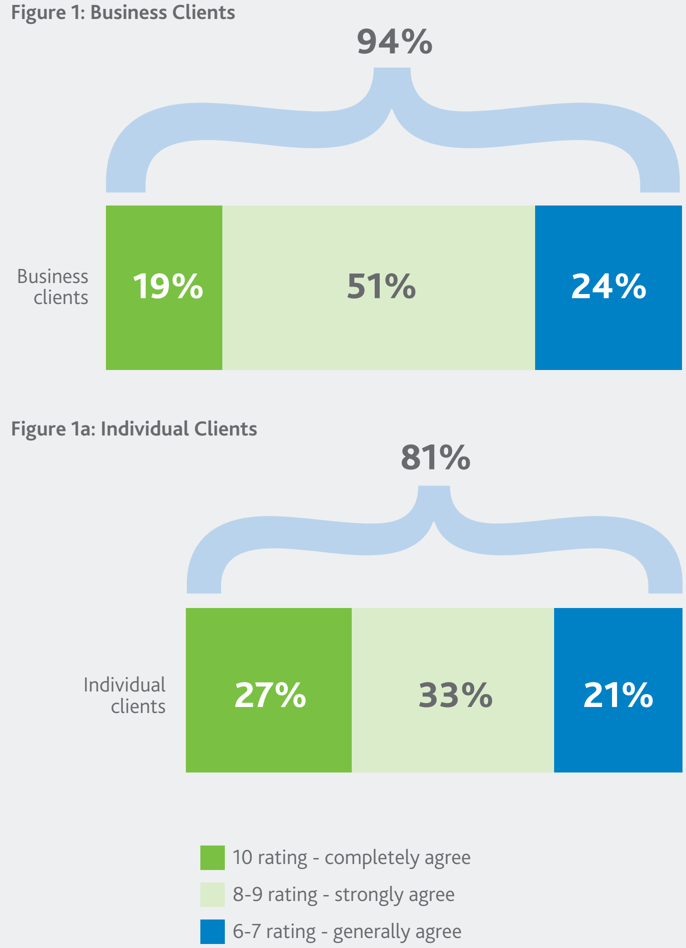
Services Clients Seek…and Areas of Opportunity for Firms to Extend Services

The *CCH Survey* asked business and individual clients to identify the types of services they need and where they used an accountant to meet those needs. Across both segments, the survey found that accounting firms have opportunities to meet a broader range of needs in their current client base, thereby strengthening client relationships.

Businesses most often rely on their CPA firm for audit and accounting (93 percent) and tax services (89 percent), with three in four (75 percent) also relying on their CPA for management advisory/consulting services.

Figures 1 and 1a: Client Perception of CPA Firm As a Valued Advisor

Figure 1: Business Clients



The audit and accounting services that business clients most often report using are audits of internal controls (50 percent), agreed upon procedures (44 percent) and audits of private companies (36 percent). The most used tax services are tax consulting (49 percent), tax preparation (49 percent) and IRS/state tax authority representation (48 percent). However, as these numbers show, only one-half or fewer businesses report obtaining even these most commonly used services from their primary CPA firm.

Businesses surveyed are far less likely to use CPA firms for management advisory/consulting services. The most commonly reported of these services that businesses use are those for employee benefits (29 percent), business valuation (27 percent) and cash flow forecasting (27 percent).

MOST COMMON CPA FIRM SERVICES AMONG BUSINESS CLIENTS

TOP AUDIT & ACCOUNTING SERVICES	TOP TAX SERVICES	TOP MANAGEMENT ADVISORY/ CONSULTING SERVICES
■ Audits of internal controls ■ Agreed upon procedures ■ Audits of private companies	■ Tax consulting ■ Tax preparation ■ IRS/state tax authority representation	■ Employee benefits ■ Business valuation ■ Cash flow forecasting

Based on these findings, accounting firms have the opportunity to work more closely with their business clients to understand their full range of needs, who is performing those services today and where those services could be provided by the firm.

For example, some businesses may be performing certain accounting or tax functions internally that could more effectively be provided by their accounting firm. It's important that firms gain deep insight and demonstrate how they can be an integral part of their client's workflow. Businesses that are looking to partner with their CPA firms to perform new and extended services will want assurance that their firm can effectively integrate with their internal organization and processes.

Among individuals, virtually all clients (99 percent) rely on their CPA firm for tax services. While they may turn to their CPA for tax preparation, however, that often is the extent of the relationship. Only 48 percent of individual clients say they have a tax planning strategy in place. The good news is that for those who do, nearly all are working with their CPA for guidance on the strategy.

However, as related to other areas where CPAs could provide advisory services, clients are generally underutilizing their CPA firms. *(See Figure 2.)* Most notably, 61 percent of individual clients say they have a budget in place and 59 percent have retirement savings plans, but few are working with their accountant to address these areas.

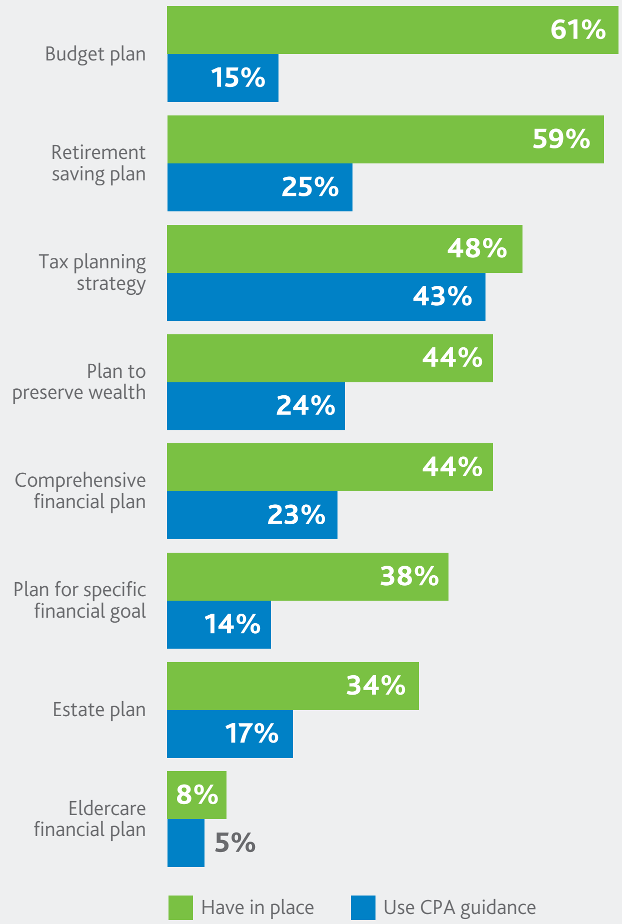
Similarly, 44 percent of individuals say they have a comprehensive financial plan and 44 percent have a plan to preserve wealth, but only about one-half of those individuals report they are working with their accountant on these plans.

Additionally, few individual clients have an estate plan or a plan to achieve specific financial goals, such as buying a home or saving for a child's/grandchild's education, and, among those who do, few look to their CPA for guidance on these plans.

One emerging area CPA firms may want to keep on their radar is eldercare financial planning. While a small number of clients report having these plans in place today, the majority of them turn to their accountant for guidance on these plans. As it's likely that this demand will increase with the aging population, firms have an opportunity to expand their services in this area.

While high-income clients are more likely than middle-income individuals to indicate their accountant is providing guidance with planning services, there is still a significant untapped opportunity across both markets for CPAs to educate their clients on the need for financial planning and help them put a plan in place.

Figure 2: Plans Individuals Have in Place and Where They Use CPA Guidance



Key Finding Summary

Informing current clients of the full range of services the firm offers and providing more of those services to them is a winning proposition, which will improve both profitability and retention for firms, as well as benefit clients. These clients are already doing business with the firm, and trust their accountant as an advisor. This trust creates an opportunity for firms to evaluate client wants and needs, map them against the firm's capabilities, and expand the services the firm provides. The additional significant benefit for the firm is that the more services a client receives, the more likely they are to stay, increasing client retention rates.

In some cases, closing the gap between client needs and firm capabilities may require investment in staff, technology or process and workflow improvements, but the investment will be well worth the return firms can expect to see. By failing to focus on more comprehensive client services, firms could be risking client satisfaction — leaving clients fair game for competitors who will do more for them.

Clients Expect Need for Services to Increase

Business and individual clients report that the amount of support they've needed from their CPA over the past few years has increased, and will continue to grow in 2011. Very few clients (5-7 percent) expect a decrease in support needs. As such, making certain that clients know the full range of services and support a firm can provide is critical.

Among businesses, increased need is most pronounced, with 45 percent expecting their needs will increase in 2011. Particularly noteworthy, 56 percent of large businesses say their need for added support will increase in 2011. Much of this added support may come in the form of specialized services. Specifically, 55 percent of businesses report that the number of specialized services they need from their accounting firm is growing — confirming a clear trend that's developed in recent years.

Figure 3: Clients Expect Growing Support Needs in 2011

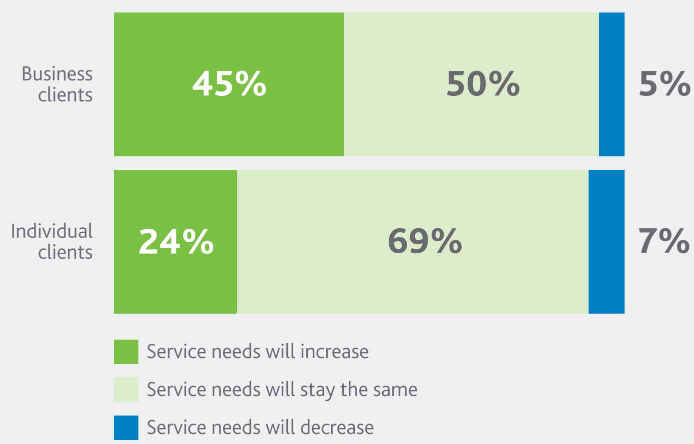


Figure 3a: Specialized Service Needs Are Growing

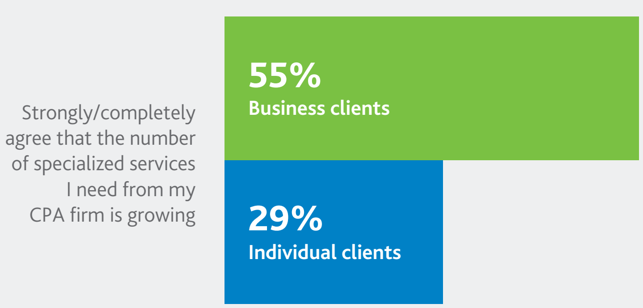


Figure 3a: Based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

Individuals also report that they will need more help going forward, with 24 percent saying the amount of support they will seek from their CPA in 2011 will increase. Additionally, 29 percent of individuals report that the number of specialized services they need from their accounting firm is growing. *(See Figures 3 and 3a.)*

Key Finding Summary

It's clear that clients' financial pictures are becoming more complex, with ever increasing opportunities and pitfalls, and they know they need more help. It's also safe to say that most don't know about the range of services their firm provides. A recent survey found that 70 percent of buyers of accounting services were not aware of all the services their firm offered, and 80 percent said they wished their firm offered services that were in fact already available from that firm. *(Hinge Incorporated, 2009)*

It's critical for firms to have solid marketing and communications channels in place to educate clients on how the firm can provide services as well as to track trends in client needs so that firms can be proactive in meeting them. By keeping on top of changing needs and increasing the depth of client services, firms can better position themselves as the strategic advisor clients want.

Minimizing Taxes are Clients' Greatest Concern

What's keeping clients up at night? Taxes. More specifically, how to minimize taxes and comply with tax regulations are their top concerns. *(See Figures 4 and 4a.)*

The five tax and financial issues of most concern for clients over the coming year are:

TOP 5 FINANCIAL & TAX ISSUES FOR CLIENTS*

BUSINESS	INDIVIDUAL
1. Minimizing taxes	1. Minimizing taxes
2. Complying with federal, state and local tax regulations	2. Preserving accumulated wealth
3. Doing a better job of business management	3. Saving for retirement
4. Payroll compliance and management	4. Avoiding an audit
5. Avoiding an audit	5. Creating or managing a budget

* Top five attributes based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

As both business and individual clients report they will need additional support from their CPA firms in the coming year, these top client concern areas provide a good indication of where additional CPA guidance may be most valued. In each of these areas, there are tools that firms can introduce to help clients improve planning, gain greater control and reduce complexity.

Figures 4 and 4a: Top Concerns for Clients

Figure 4: Business Concerns

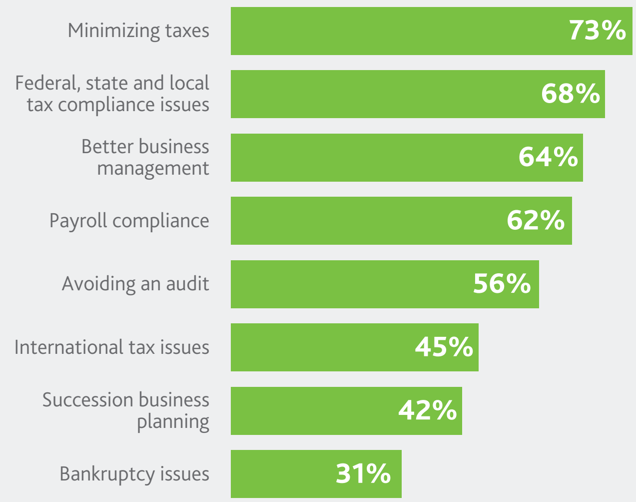
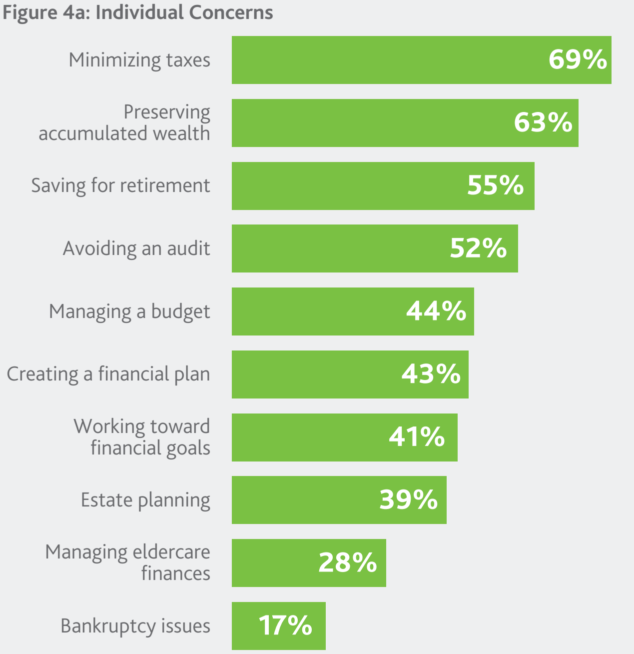


Figure 4a: Individual Concerns



Figures 4 and 4a: Based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

TOUGH TIMES: ECONOMIC UNCERTAINTY IS TOP TREND EXPECTED TO IMPACT BUSINESS CLIENTS

Business clients of all sizes are concerned about the impact of external forces on their organizations over the coming year. Chief among these external forces is the economy. In fact, over the next year, 70 percent of businesses report that economic uncertainty will have a significant impact on their businesses.

Among other issues business clients report as significantly impacting their businesses are:

- Higher federal taxes — 64 percent;
- Increased accounting-related regulation — 64 percent;
- Higher state and local taxes — 63 percent; and
- Technology issues — 61 percent.

Additionally, 44 percent of business clients report that globalization and the move to IFRS will have a significant impact on their businesses in the coming year. *(See Figure 5.)* Large companies are more likely to report this as having a significant impact, with 57 percent of companies with revenues of $500 million or more doing so.

In tough times, firms need to be even more focused on understanding their clients and serving them the very best they can. As the economy struggles, companies also are struggling to maintain good financial health and performance margins. With some levers of growth stalled right now, minimizing taxes can become an even more critical component of financial management.

A complete service strategy needs to take into account a variety of factors, including the impact of external forces. For example, when the economy is struggling, clients can often feel the most anxious. This is a likely time for them to reassess their needs, and it's important that firms keep in close contact to make sure they understand how client needs are shifting.

Figure 5: Top External Trends That Concern Business Clients

Figure 5: Based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

Clients Are Focusing on Value

At the same time that clients want more from their CPA, they also are becoming more price-sensitive. Clients report different experiences with CPA firm pricing over the last two years. Slightly more than one-half of businesses (52 percent) report that their CPA firms have raised prices, while 44 percent say their firm has held pricing steady.

Overall, 68 percent of business clients say they are becoming more sensitive to pricing and 60 percent are becoming more focused on the return they are getting from their CPA firm. Nearly as many, 56 percent, also are becoming more selective about the CPA firms with which they do business.

Individual clients are somewhat less cost-conscious, although it is still a concern. Thirty-nine percent report their firms have increased prices, and 42 percent report they are focusing more on the return they are getting from their CPA firm, while 42 percent are also becoming more selective about the CPA firm they use. *(See Figures 6 and 6a.)*

Figure 6: Baseline Client Expectations for Firm

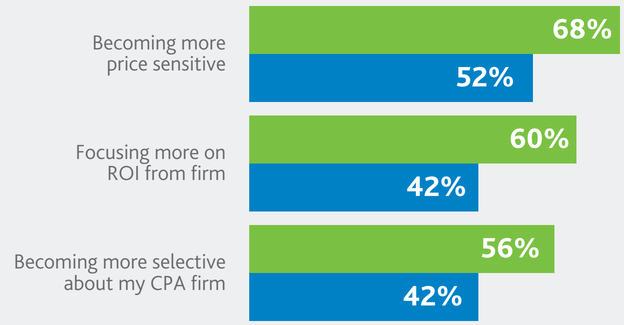


Figure 6a: CPA Firm Pricing Strategy

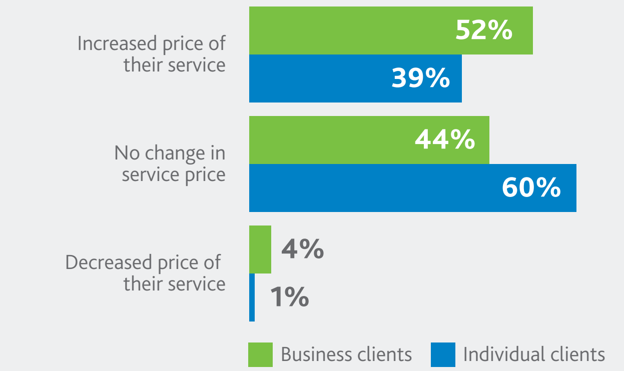


Figure 6: Based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

Key Finding Summary

Clients' needs for specialized services are growing and the support they are seeking from CPA firms also is increasing. Yet, they are more closely focused on cost and more sensitive to pricing issues. As a result, a firm's ability to improve its productivity and efficiency, as well as demonstrate value at every point of service, is critical.

Today, firms must ensure their partners and staff are focused on expanding and adding value to client services and not wasting valuable time on low-value activities. One important way firms can help their teams be more productive is by leveraging integrated information and technology solutions to streamline workflows and automate processes. In fact, 100-percent of high-performing firms report that it is critical to have technology and information resources that enable a firm to provide high value-added services.

FIRM SELECTION CRITERIA: THE COURTING PERIOD

Finding a CPA Firm

Referrals are the leading way both businesses and individuals hear about potential CPA firms to hire, according to the *CCH Survey*. In fact, 67 percent of business clients and 76 percent of individual clients cite referrals as the way they found their CPA firm. Not surprisingly, business clients most often rely on referrals from other professionals, while individuals rely on referrals from friends.

However, business clients also listen to their friends, and individuals seek referrals from other professionals with whom they work. As a result, every point of contact by a firm with clients, as well as with professional associates, can create opportunities for new business.

Most clients appear willing to provide referrals. Seventy-two percent of business clients and 78 percent of individual clients have recommended their CPA firm to someone else and 85 percent of business clients and 84 percent of individual clients say they are likely to do so in the future. *(See Figures 7 and 7a.)*

Figure 7: Primary Source of Learning about Current CPA Firm

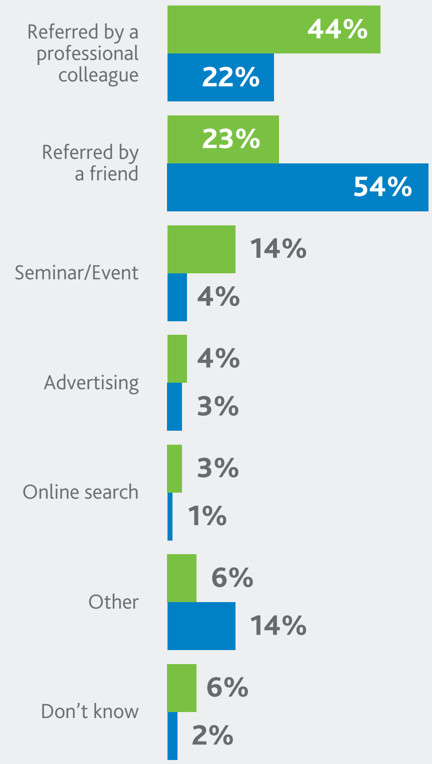


Figure 7a: Client Referrals

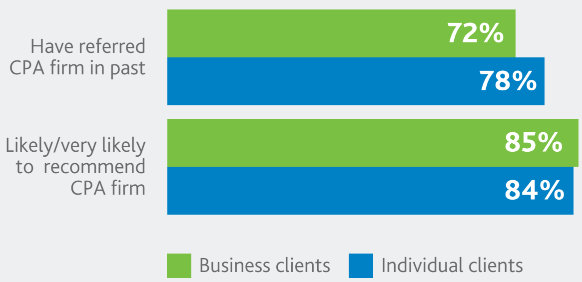
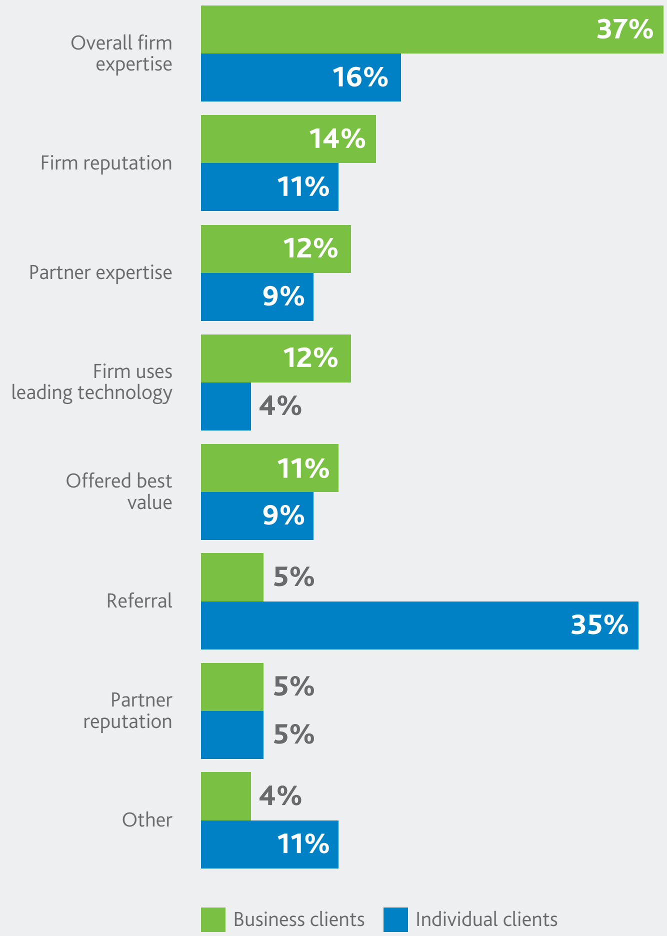


Figure 8: Drivers in CPA Firm Selection



As a profession, CPA firms can be proud that so many clients have and are willing to recommend their practices. Firms should leverage this good will and use the endorsements to both strengthen relationships with existing clients as well as build relationships with new clients. They also should carefully monitor changes in their own referral rates and watch for any decline in ratings so that corrective action can be taken as soon as possible.

Choosing a CPA Firm

When it comes to the actual selection of their current firm, referrals still matter most among individuals, but take a back seat to other factors for businesses.

The most cited selection criteria by businesses are firm expertise, firm reputation, partner expertise, firm's use of technology and value. *(See Figure 8.)*

PRIMARY DRIVERS IN CPA FIRM SELECTION

BUSINESS	INDIVIDUAL
Overall firm expertise	Referral
Firm reputation	Overall firm expertise
Partner expertise	Firm reputation
Firm uses leading technology	Offered best value
Offered best value	Partner expertise

Business and Individual Clients Seek Common Firm Attributes

Among business and individual clients, core expectations center on basic competencies. And while business and individual rankings vary slightly from a numeric perspective, they report similar priorities. *(See Figure 9.)*

Specifically, the top attributes clients use to choose a CPA firm include:

TOP ATTRIBUTES FOR CHOOSING A CPA FIRM*

BUSINESS	INDIVIDUAL
Firm partners and staff are easy to reach and responsive	Information firm provides me is accurate and authoritative
Information firm provides me is accurate and authoritative	Firm partners and staff are easy to reach and responsive
Firm is active in the profession and keeps up with changing regulations	I have trust in the firm and its ability to deliver the services I need
I have trust in the firm and its ability to deliver the services I need	Firm provides services/ guidance to help lower my taxes
Firm keeps me up to date on regulations that directly affect me	Firm ensures accuracy of my client information
Firm demonstrates efficiency	

* Top five attributes based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

Figure 9: Attributes for Choosing a CPA Firm

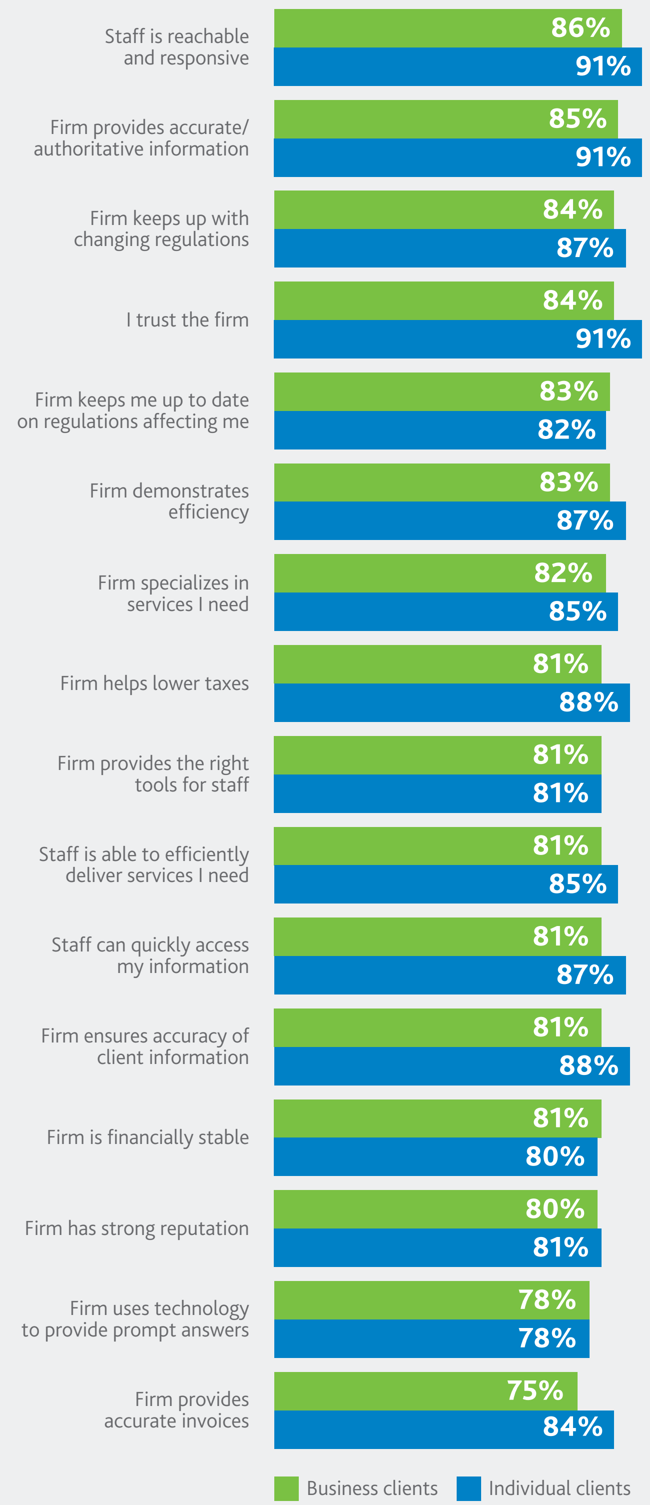


Figure 9: Based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

Clients' Advice on Winning and Keeping Their Business

The best way to keep your clients is to keep your clients satisfied. According to respondents nationwide, it's a matter of delivering knowledgeable service for a good value in a timely way.

WHAT CPA FIRMS NEED TO DO TO KEEP/WIN BUSINESS

BUSINESS	INDIVIDUAL
1. Demonstrate knowledge/experience 2. Provide reasonable cost for services 3. Deliver efficient/quick service	1. Provide reasonable cost for services 2. Understand my needs 3. Demonstrate responsiveness

For firms to understand what is important to their clients, and how the firm is performing against those expectations, it's important for firms to keep in close contact with clients. Successful firms use a variety of ways to do this, including formalized surveys that allow a firm to regularly benchmark clients' needs and firm performance.

Firms should also realize that clients have service expectations not only from the standpoint of the expertise a firm provides, but also the service channels through which this expertise is delivered. In fact, for businesses today, efficient and quick service is one of the three most important things their CPA firm can deliver; and for individuals, it's responsiveness that counts.

As firms consider their service strategy, delivery channels should play an important part of that strategic plan. Firms should be asking not only what services clients want, but the most effective and desired ways to deliver those services. And they should ask this often because client service is being redefined every day by other professional service providers and clients' individual experiences.

FIRM PERFORMANCE: SATISFACTION ONCE SELECTED

Most Firms Fail to Seek Formal Feedback

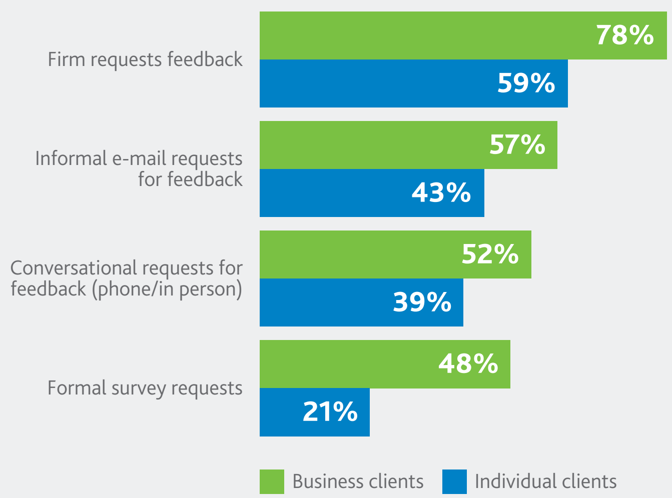
Based on the *CCH Survey* results, most CPA firms do not have a formal program for gathering feedback from either business or individual clients. Forty-eight percent of business clients and just 21 percent of individual clients report receiving a formal client satisfaction survey from their CPA firm in the past year. While both business and individual clients report that they receive requests for feedback more often on an informal basis through phone conversations or e-mail, this activity is also limited. *(See Figure 10.)*

Key Finding Summary

As the saying goes, we manage what we measure. So it's surprising that given the importance of client satisfaction and retention today, firms are not measuring client needs and their own performance in a formal way.

By supplementing current feedback mechanisms with a formal client satisfaction survey, firms can gain important insights to help ensure client retention. A satisfaction survey is also an important way to demonstrate to your clients that you understand their needs and are proactive in responding to them. Remember, most clients won't tell you they are dissatisfied unless you ask them. They'll just stop doing business with you.

Figure 10: Firm Feedback Mechanisms



Client Satisfaction Varies

Satisfaction among business clients with their accounting firm shows room for improvement. While 79 percent report they are generally satisfied with their CPA firm, only 17 percent of that group indicate they are completely satisfied with their CPA firm.

Client satisfaction is stronger among individual clients, with 87 percent reporting they are generally satisfied with their current firm. Of that group, however, only 39 percent are completely satisfied.

When asked about the value they derived from their interactions with the firm's professionals, both business and individual clients report the relationship they have with the firm partner(s) is most important. Specifically, 47 percent of business clients report they derive the greatest value from their relationship with a firm partner. Individual clients are significantly more likely to say their relationship with a firm's partner is most valued. Specifically, 66 percent of individual clients most value their relationship with their firm's partner, and among high-income clients, 73 percent report they most value their relationship with a firm's partner.

Business clients, however, are more likely than individuals to value non-partner professional staff, with 42 percent reporting they derive the greatest value from working with their firm's non-partner CPAs. Only 21 percent of individual clients report they realize the greatest value from their relationship with their firm's non-partner CPAs. *(See Figures 11 and 11a.)*

Figure 11: Overall Client Satisfaction

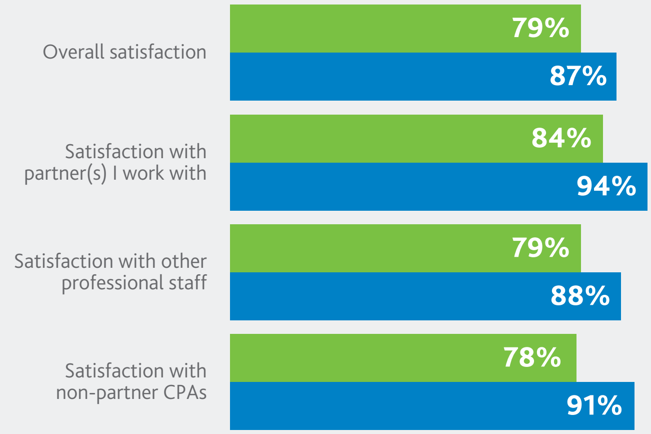


Figure 11a: Most Valued Firm Interactions

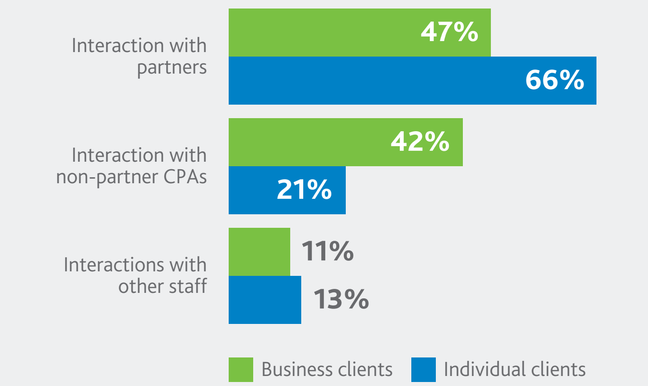


Figure 11: Based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

Firm Performance v. Client Expectations Shows Gaps

Overall, the *CCH Accounting Firm Client Survey* suggests that firms are doing a good job in meeting client expectations. However, clients believe there is room for firms' performance improvement across each of the attributes they consider most important. Examining both the attributes that clients believe to be most important in choosing a firm and how well they report their current firm is performing in these key areas reveals gaps that could lead to client losses if left unaddressed.

Among the attributes that businesses rank as most important, there is the largest performance gap between what clients want when choosing a CPA firm and how well they rate their current firm on these attributes:

- Firm provides services/guidance to help lower my taxes.
- Firm equips its staff with the right tools to perform my work.
- Firm specializes in the types of services I currently need.
- Firm keeps me up to date on regulations that directly affect me.
- Firm is active in the profession and keeps up with changing regulations.

Among the attributes that individuals rank as most important, there is the most significant performance gap between what clients want when choosing a CPA firm and how well they rate their current firm on these attributes:

- Firm keeps me up to date on regulations that directly affect me.
- Firm provides services/guidance to help lower my taxes.
- Information firm provides me is accurate and authoritative.
- Firm is active in the profession and keeps up with changing regulations.
- Firm specializes in the types of services I currently need. *(See Figures 12 and 12a.)*

In no instance across business or individual clients did firm performance exceed client expectations.

Key Finding Summary

Certainly, closing the gaps is essential, but firms should also look to exceed client expectations, if they want to ensure satisfied clients over the long term. One way firms can do this is to undertake their own gap analysis and then determine what is needed to close the gaps as quickly as possible. Levers to consider in closing the gaps include technology and workflow solutions, practice management changes or staffing changes, with some of the fixes being fairly simple. For example, both individual and business clients report their current firms are not performing as well as they would like when it comes to keeping them up to date on regulations that affect them or providing guidance to help lower their taxes. Today, there are many information services, software and web-based solutions readily available that a firm can deploy immediately to help them meet client expectations for these services.

Figures 12 and 12a: Gap in Firm Performance Relative to Importance

Figure 12: Business Clients

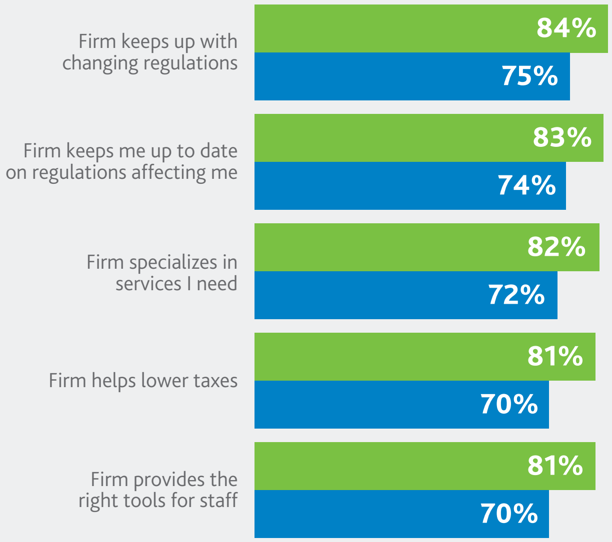
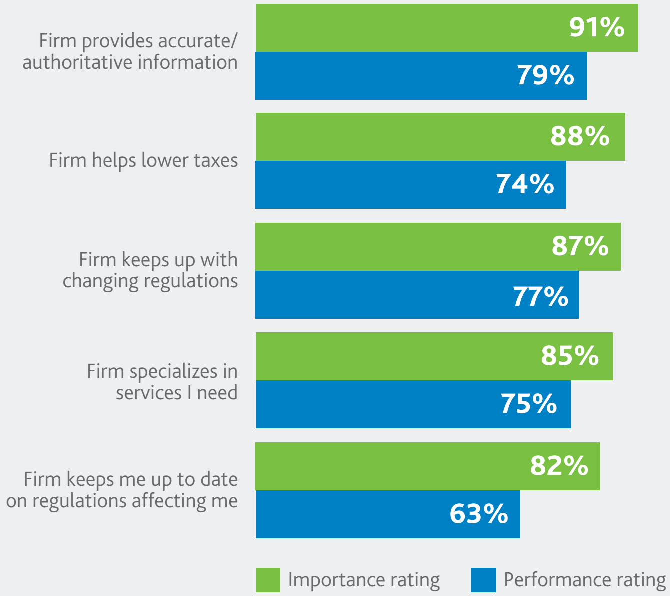
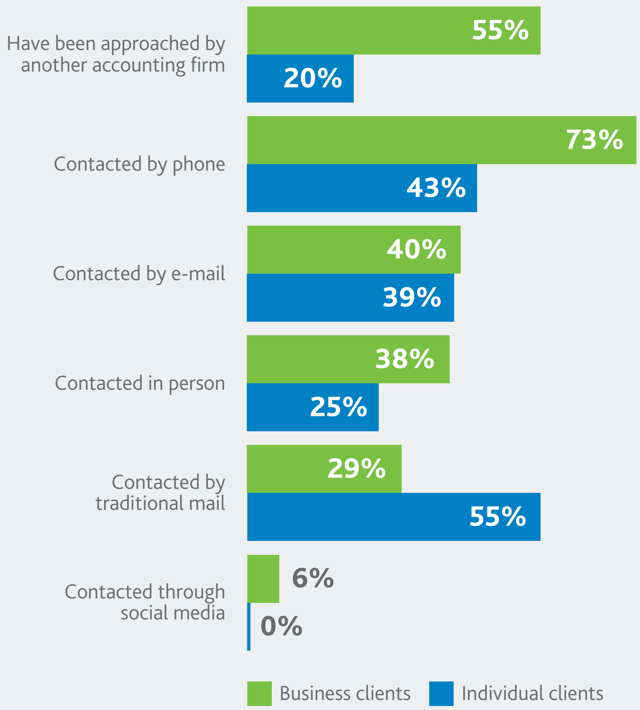


Figure 12a: Individual Clients



Figures 12 and 12a: Based on percent of respondents rating attribute an 8, 9 or 10 on a 10-point scale.

Figure 13: Competitor Firm Prospecting Methods



Figures 14 and 14a: Likeliness to Switch Firms

Figure 14: Business Clients

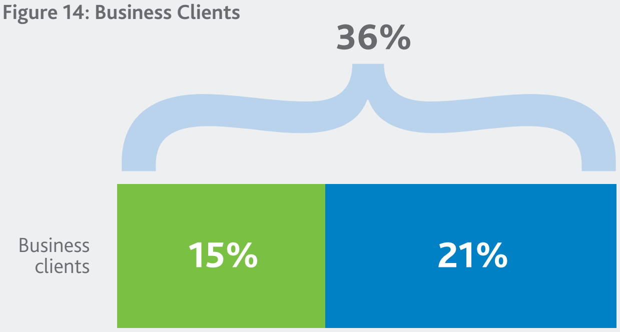
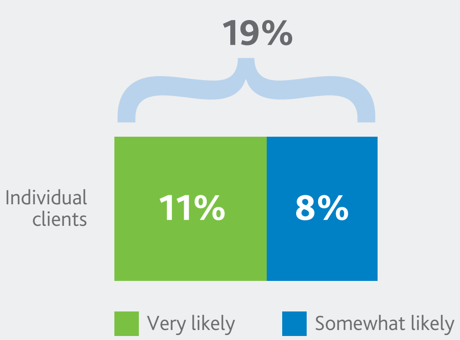


Figure 14a: Individual Clients



RETENTION: WILL THEY STAY?

Competitors Turn Up the Heat with Prospecting

While firms may not be proactively checking in with their clients to see if they are satisfied, in many cases the competition is. Many clients, particularly business clients, report they are being approached by other CPA firms for their business. In fact, 55 percent of businesses say they have been approached by other firms during the past year. The most common ways firms are reaching out to prospective clients are by phone and e-mail. Business clients also report being recruited through in-person meetings, mail and social media.

While more than one-half of business clients report being prospected, just 20 percent of individual clients say they have been contacted by another CPA firm, most often through traditional mail or phone calls. However, it's important to note that while individuals may not be prospected directly by other CPA firms, they are also being inundated with advertising and marketing materials from other tax preparation services, brokerage firms and financial planning and services providers.

Given the limited number of firms that report conducting formal client satisfaction surveys, it appears some firms are doing more to attempt to recruit new clients than they are to retain existing ones, despite the high cost of replacing existing clients. *(See Figure 13.)*

Plans for Staying with Current Firm Uncertain

While clients overall tend to have longstanding relationships with their CPA firms, there appears to be the potential for considerable client turnover in the next year. In particular, 36 percent of business clients report they are somewhat to very likely to switch firms, while 19 percent of individuals are contemplating a switch. *(See Figures 14 and 14a.)*

When clients were asked what would make them leave their CPA firm, the top reason clients would consider leaving is if their firm did not regularly check with them on their changing needs.

Overall, clients want to make sure that their firm is staying on top of their needs; delivering quality services; working very efficiently; investing in the latest technology resources; and delivering the value they expect. While these expectations are perfectly reasonable, firms can be challenged in delivering equally well on all fronts if they are not optimizing technology.

Using technology as a strategic resource is a trademark of the most successful firms, and high-performing firms place an emphasis on harnessing technology to achieve their goals of improving staff productivity, client service, practice management and profitability.

Top technologies that firms leverage to make such improvements include document management systems, software as a service (SaaS) solutions, multiple monitors, integrated tax and accounting suites and compliance solutions, practice management systems, intelligent scanning tools, client portals and knowledge management systems. High-performing firms also report that technology to facilitate anywhere, anytime client communication and interaction is critical in optimizing client services.

TOP 10 REASONS WHY CLIENTS LEAVE

BUSINESS	INDIVIDUAL
1. If the firm does not regularly check with me on my changing needs	1. If the firm does not regularly check with me on my changing needs
2. If staff in the firm was not able to efficiently find the information needed to deliver the service I need	2. If I lost trust in the ability of the firm to deliver the quality services I need
3. If I believed the firm was charging more than the value I was receiving	3. If my taxes seemed higher than they should be
4. If it became apparent that the firm was not leveraging technology to deliver the best service possible to me	4. If the firm no longer specialized in the types of services I need
5. If the firm did not keep me up to date on regulations that directly affect me	5. If I believed the firm was charging more than the value I was receiving
6. If I became concerned about the firm's financial stability	6. If I was audited more than once
7. If the firm no longer specialized in the types of services I need	7. If staff in the firm was not able to efficiently find the information needed to deliver the service I need
8. If I lost trust in the ability of the firm to deliver the quality services I need	8. If it became apparent that the staff did not have the right tools to perform my work
9. If it became apparent to me that the firm was not acting as efficiently as it should	9. If the firm did not keep me up to date on regulations that directly affect me
10. If the firm had difficulty in recruiting or retaining talented employees	10. If the firm engaged in activities that reflected poorly on their reputation

MULTIPLE POINTS OF CONTACT

Both business and individual clients tend to have longstanding relationships with their primary CPA firm. On average, companies have been with their current CPA firm for eight years and 25 percent have been with the same CPA firm for 11 or more years.

Individual clients report even longer relationships with their accountant, averaging nine years, with 31 percent having the same CPA for 11 or more years. *(See Figure 15.)*

As firms look at the value they offer to clients, they need to look at all touch points in their relationships with clients. *(See Figure 15a.)* This should include the interactions clients have with the firm's entire staff, from partners to administrative personnel, as well as the interactions clients have through other touch points and service channels such as the firm's website, online tools and portals.

Firms should challenge themselves to refresh their service channels as defined by the value clients place on them today. For example, it's clear that clients value time with partners, but they also place very high importance on efficiency and responsiveness. As firms look to improve profitability and meet clients' growing expectations, just-in-time information and technology-based self-service delivery touch points will become an even more important part of shaping the client experience.

Firms should create blended service models, including self-service channels, to ensure clients have fast and easy access to key information.

Figure 15: Tenure with Current CPA Firm

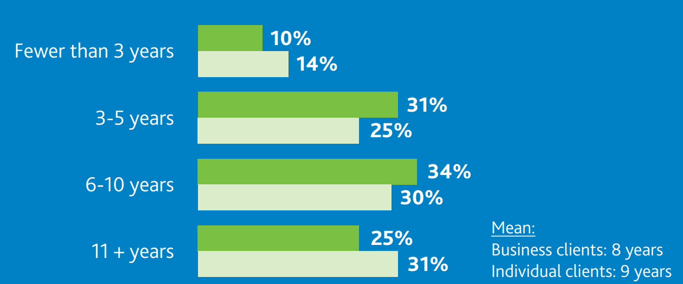
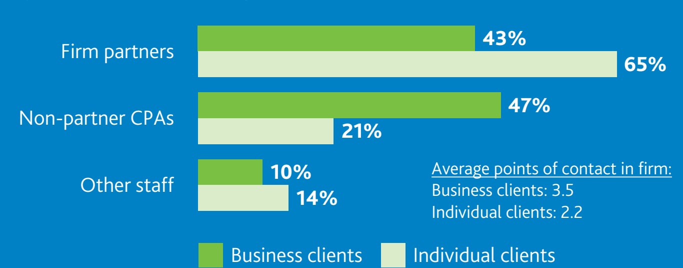


Figure 15a: Most Frequent Points of Contact at CPA Firm



COMMUNICATING IS CRITICAL

The *CCH Survey* found that the leading reason clients will switch firms is if the firm does not regularly check on their changing needs. This means firms need to be continuously engaged in two-way communications with clients.

Overall, CPA firms tend to have more contact with their business clients than their individual clients, and how they stay in touch includes a variety of communications channels.

Generally, business clients report the most common ways their firm communicates with them are: phone (94 percent), e-mail (93 percent) and in person (91 percent).

Among business clients meeting with their firms in the past year, they did so an average of five times. The majority of clients (73 percent) still regularly receive traditional mail from their CPA firm, although this is likely dwindling, while 57 percent of business clients report frequently or occasionally communicating with their firm via online dedicated portals as firms adopt new ways of reaching their clients. Notably, the use of online portals jumps even higher, to 72 percent, for large business clients.

Individual clients report the most common ways they are in contact with their CPA are: phone (79 percent), in person (69 percent), traditional mail (66 percent) and e-mail (58 percent). Among individual clients who met with their firms in the past year, they had an average of three meetings. The use of dedicated online portals is now being adopted by individual clients, with 21 percent reporting they are frequently or occasionally using portals to communicate with their CPA firm. *(See Figures 16 and 16a.)*

The Changing "Face" of Service

While face-to-face meetings have been a traditional way firms have conducted business, this may be shifting — particularly among business clients where only 39 percent report that their preferred way of working with the CPA is in person. For individual clients, 60 percent say they prefer in-person contact with their CPA.

Figure 16: Clients Report Their CPA Firm Uses the Following Communications Methods Frequently/Occasionally

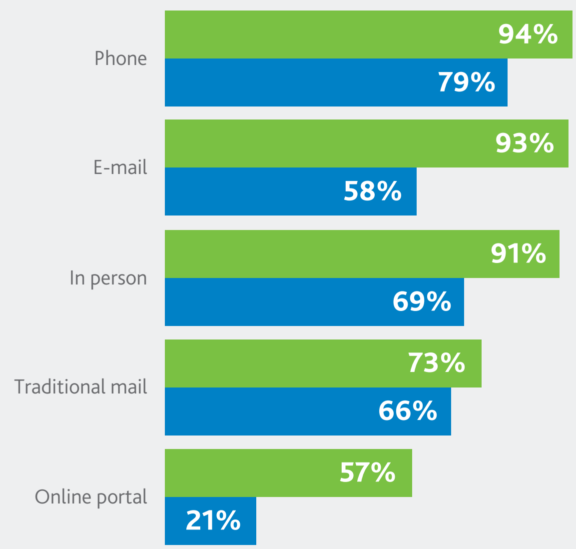
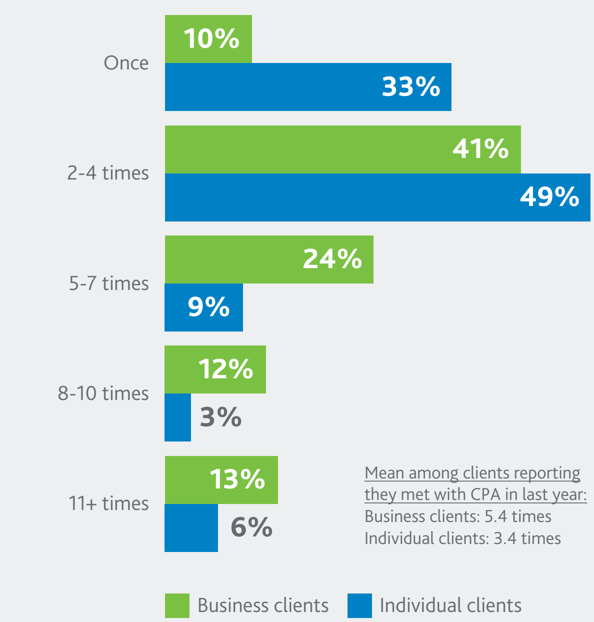


Figure 16a: Frequency Clients Meet with CPA Firm Staff Per Year*



* Among clients reporting they have met at least once in the past year with their CPA firm staff.

The *CCH Survey* clearly shows that today portals are more commonly used among business clients, while they are still emerging in the individual market. Based on ease of use, efficiency, increasing regulatory requirements and security advantages, the adoption of portals will continue to increase as a communication and service delivery channel for both individual and business clients.

For many accounting firms, portals will also serve as a foundation for future self-service applications. Portals allow clients to securely and easily communicate with the firm, access services and work with their information, when and where they want — whether during "business" or "real life" hours.

As many financial services, such as banking and investment services, are already provided in this way today, it's likely clients will come to expect this level of accessibility, control, flexibility and responsiveness for certain accounting services as well. In fact, individual clients report they're already conducting web-based transactions in those other areas today. Seventy-six percent use online banking and 49 percent report using other online financial services. And, as the next generation of clients is coming on board, they're often more comfortable jumping online to tap into a knowledge base than picking up the phone and hoping to reach someone right away who can answer their questions or provide service.

As clients become even more accustomed to self-service solutions in their other consumer experiences and more next-generation clients come on board, they will increasingly demand the ability to conduct certain aspects of business on their own terms — using self-service solutions when they are most convenient and saving face-to-face and phone conversations for high-value consultative purposes with firm partners and professional staff.

Social Media Emerging As a Communication Tool

Social media as a means of communicating with clients is just emerging and is more commonly used with business clients than individuals.

Specifically, among business clients, anywhere from 25 to 41 percent are communicating frequently or occasionally with their CPA firms using various social media tools, such as professional online communities, LinkedIn, blogs, Facebook and Twitter. In just about all instances, large companies are significantly more likely to be communicating with their firms using these social media forums.

In fact, respondents from large companies overall are far more likely to use social media of all types for professional purposes. As a result, firms should make certain they have the appropriate social media channels available to stay in touch and that they are providing staff with the knowledge to use these tools appropriately to advance the firm.

Figure 17: Client Use of Social Media for Communicating with CPA Firm Frequently/Occasionally

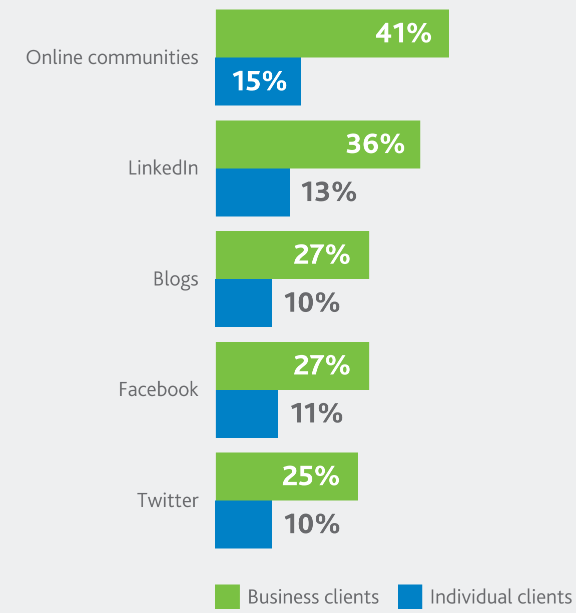
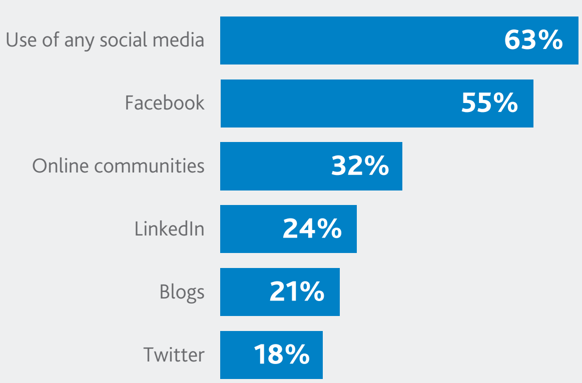


Figure 17a: Individual Use of Social Media – Beyond Firm Contact



Among individual clients, the use of social media for communicating with their CPA is still limited, with 15 percent or fewer reporting they use Facebook, blogs, LinkedIn, Twitter or online communities to frequently or occasionally communicate with their CPA firm. That's not to say that individuals are not using these channels for other purposes, however. In fact, more than one-half of individual clients are on Facebook, nearly one-third are using online communities and nearly one-fourth are using LinkedIn. *(See Figures 17 and 17a.)*

Clients May Not Be Making Most of Websites

While a firm's website can be a powerful tool in client communication and service strategies, use of firm websites by clients is mixed. Overall, business client visits to their CPA firm's website is strong, with 73 percent having visited their CPA firm's website in the past year, for an average of five times. Large businesses are more likely than others to have visited their firm's website with seven visits.

Conversely, 64 percent of individual clients report they have *not* visited their CPA firm's website in the past year. The average number of visits for those who have done so is five times.

These findings indicate that firms need to provide greater value to individual clients via websites. One way to do this is by leveraging websites more effectively. For example, a key concern of clients is making sure that their firm has accurate information about them. Through a secure website, firms could provide clients with the ability to view and update this information themselves. Another top concern for clients is keeping current with new developments. Websites that offer frequent informational updates can be a valuable resource for clients who want to know about the changes affecting them.

Custom newsletters, print or online, are another means of communicating with clients. Seventy percent of companies report receiving regularly issued newsletters from their CPA firm, while only 36 percent of individual clients receive this information.

BREAKING BOUNDARIES: BUSINESS TECHNOLOGY TRENDS

Understanding clients' technology adoption rates and preferences is important in making certain that firms are keeping up with clients' technology expectations. The *CCH Accounting Firm Client Survey* showed that clients are increasingly moving beyond boundaries of time and place…and they are expecting the same from their CPA firms. Clients work anytime, anywhere, and they want the same from their accounting firm.

Cloud Computing: From Trend to Practice

Cloud computing and SaaS technologies are being quickly adopted by all types of businesses. To stay competitive, leading CPA firms are now stepping beyond the boundaries of premise-based platforms to embrace SaaS. In the cloud, all data and applications are hosted online where professionals can access them from anywhere over the web using the latest mobile computing and communications platforms.

Business clients are in the cloud and cloud applications are particularly prevalent among large and mid-size businesses.

Overall, 62 percent of business clients surveyed either are or will be using a cloud-based accounting system. Nearly one-half (49 percent) of large businesses already do so, with 20 percent more planning to do so in the next three years. Similarly 38 percent of mid-size businesses do today and 31 percent more plan to do so within three years.

And companies overall report they are not finished moving to cloud computing, with 69 percent reporting their usage is likely to increase over the next three years. *(See Figures 18 and 18a.)*

Figures 18 and 18a: Cloud Computing Trends – SaaS Adoption Among Business Clients

Figure 18: Current/3-Year Plans for Specific SaaS Applications

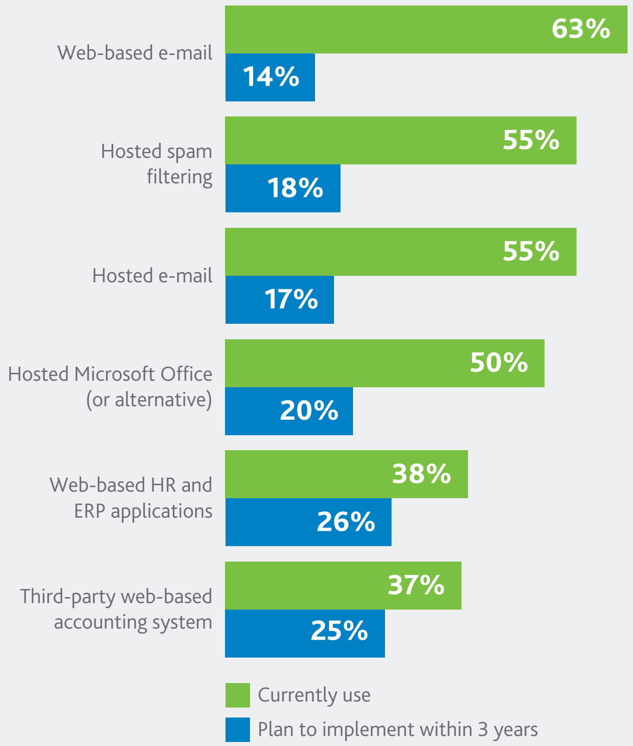
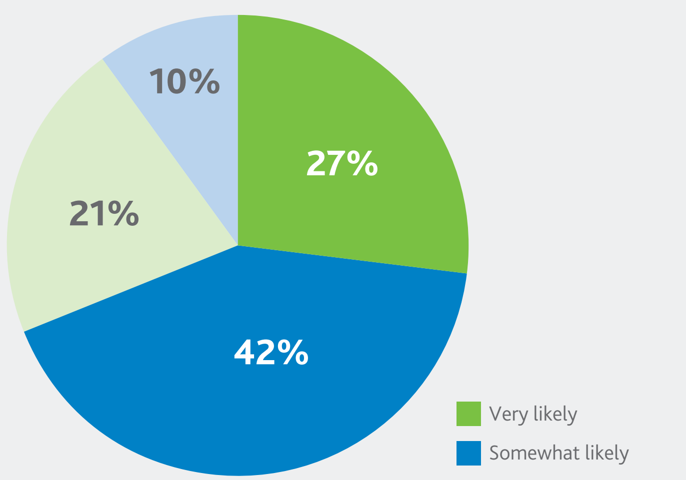


Figure 18a: Overall Planned Increases of SaaS Usage Over Next 3 Years



Figures 19 and 19a: Business Clients' Digital Process Trends

Figure 19: Likeliness to Expand Digital Environment (Next 3 Years)

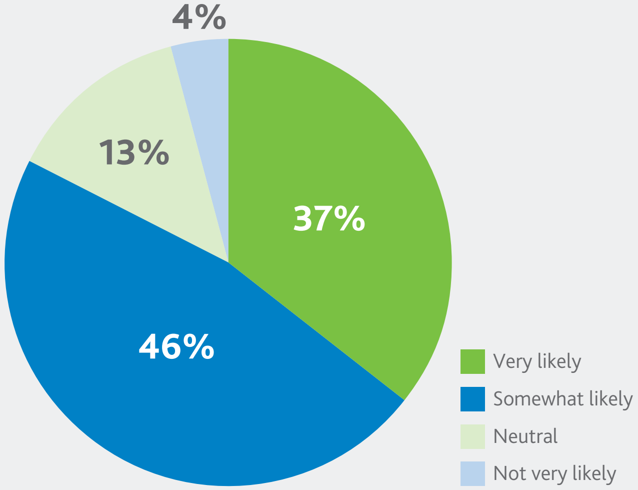
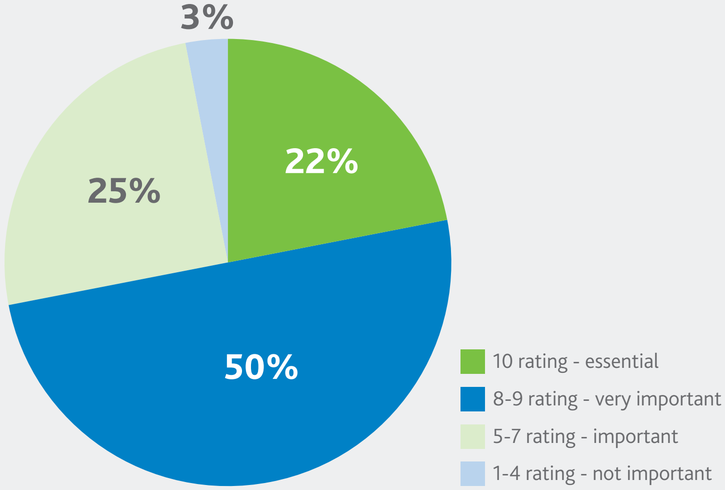


Figure 19a: Importance of CPA Firm Using Digital Processes



While some IT departments both in businesses and CPA firms are reluctant to give up control of their platforms, those that do quickly realize their platforms actually operate more dependably in the cloud. Among the benefits of a SaaS environment are:

- Features and functions that allow organizations to work smarter, quicker and more efficiently.
- An infrastructure to promote a collaborative environment that helps to attract and retain today's workforce and solidifies ties with clients.
- Puts more information at the point of client contact, so organizations can deliver greater value.

Organizations of all types are recognizing these benefits. Leading CPA firms are as well.

Business Clients Are Moving to Secure Paperless Environments

Business clients report that they also are breaking down the boundaries by moving to digital environments. Specifically, 83 percent of businesses report they will move more of their processes away from paper to digital. And, they expect their CPA firms to do the same, with 72 percent saying it is essential or very important for their CPA firm to work in a digital environment. *(See Figures 19 and 19a.)*

With the increasing growth of digital environments, data security also is important, with 68 percent of companies reporting they have a secure data exchange policy. These policies are most prevalent among large businesses, where 81 percent have them. Data security also must become a priority for CPA firms. Today, as more states move toward requiring secure encrypted data transmission of financial data, it's clearly a best practice that all firms should be adopting.

In a digital environment, business professionals can work from anywhere and businesses can more easily form partnerships to improve their efficiency and profitability. For example, 37 percent of businesses currently outsource at least some of their IT function and another 30 percent plan to do so within the next three years.

CONCLUSION: CLIENT RETENTION THROUGH BETTER CONNECTIONS

Client retention is critically important to a firm's profitability, with excellent client service and high satisfaction levels supporting strong retention rates. Yet, as the *CCH Accounting Firm Client Survey* indicates, many clients are considering switching CPA firms and many are being prospected by other firms.

Firms that want to keep their clients, need to keep their clients satisfied. To achieve this, firms must have in place a successful client service strategy that's founded on effectively connecting with clients and meeting their needs with high-value, timely services. Here are some important steps firms can take to accomplish this:

- **Keep the lines of communication open and active.** The top reason clients said they'd leave their firm was if the firm wasn't checking in with them on their changing needs. Ask, and ask again. Ensure you have formal channels, such as surveys and client advisory groups, as well as informal feedback mechanisms in place to provide timely client insight. Also, be active in keeping clients advised of service opportunities. Leverage your website, e-mail, newsletters and social media to keep clients current on how you can serve them best.
- **Optimize existing client relationships with extended services**. While clients' needs are on the rise, many clients are unaware of the full range of services their accounting firm offers. Firms have opportunities to meet a deeper range of needs in their current base of clients, thereby strengthening client relationships and improving retention. Put a plan in place to periodically and formally evaluate client needs, and communicate regularly to clients about firm capabilities. Firms may also want to categorize clients, and focus on certain segments of clients who have specialized needs. Firms should also ensure that everyone on their professional staff understands their role in business development, so that at each point of service, the holistic needs of the client are considered.
- **Reevaluate your service channels to make sure you are delivering value at every touch point.** Do you know how your clients value receiving service? It may surprise you. Clients clearly value contact with partners and face time is still very important, but people now also place a premium on responsiveness, speed, convenience and accessibility of services. Make sure you offer a blended service delivery model that provides value at every point for your clients. For example, firms can leverage client portals to achieve new levels of efficiency, productivity and service excellence for clients, as well as the firm, while also supporting new revenue streams.
- **Close the performance gaps.** Clients believe there is room for firms to improve performance across each of the attributes they consider most important in an accounting firm. Firms need to examine both the attributes clients say are most important and how well clients think the firm is performing in these key areas to reveal any gaps. In some cases, closing the gaps may require investment in staff, technology or process and workflow improvements, but the investment will be worth the return firms can expect to realize from client longevity.
- **Leverage technology to drive success.** Technology is foundational to your business performance and central to your client service strategy. Business clients say that a firm's use of leading technology is among their top criteria in selecting a firm. These clients are also active in leveraging technology in their own businesses and they expect their firm to do the same, whether it's working in the cloud or digitizing their environment. Firms need to have in place technology solutions that enable the delivery of high-value services; streamline workflow and enhance staff efficiency and productivity; create greater connectivity and collaboration with clients; and support the ability for clients and firms to do business anytime, anywhere.

ABOUT THE SURVEY

2010 CCH ACCOUNTING FIRM CLIENT SURVEY

The 2010 *CCH Accounting Firm Client Survey* includes quantitative interviews with a total of 675 buyers of accounting services: 459 business professionals who have responsibility for working with their organization's CPA firm and 216 individuals who use a CPA firm. The survey was undertaken to determine client selection criteria and client satisfaction to help firms attract and retain both business and individual clients by better understanding their wants, needs, perceptions and motivations. The survey was conducted online by Opinion Research Corporation (ORC) from August 11-24, 2010. The survey reflects experiences of randomly polled business professionals working at organizations with revenues from $5 million to more than $500 million and individual consumers with incomes from $50,000 to more than $100,000. In order to understand attitudes, behaviors and needs within business size and consumer income sub-segments, the data is unweighted.

The following terms are used in and defined as in this report:

- Small business: organization with revenues of $5 million to $50 million;
- Mid-size business: organization with revenues of $50 million to $500 million;
- Large business: organization with revenues of $500 million or more;
- Middle income: individuals with household incomes of $50,000 to $100,000;
- High income: individuals with household incomes of $100,000 or more.

Client Satisfaction: Getting Started with Your Own Firm's Client Survey

As part of the *CCH Accounting Firm Client Survey,* CCH undertook an extensive survey with accounting firm clients of all types – including small to large businesses and middle- to high-income individual clients. The *CCH Survey* found that few firms actually undertake a formal client satisfaction survey with their own clients.

There is, however, a clear link between client retention and client satisfaction. Therefore, firms that want to keep clients, and keep them more satisfied by meeting their full range of needs, should regularly ask clients for feedback.

The following 20 questions provide a foundation for getting started. Firms should also customize the survey based on their own client base so that they have a truly clear picture of client wants and needs. Additionally, firms may want to consider having a third party issue the survey to ensure clients feel comfortable providing open and honest feedback.

1. How did you first hear about our firm?
2. What was the primary reason you selected our firm?
3. Looking at the attributes that were most important to you in selecting our firm, please describe how well our firm performs on these key attributes.
4. Overall, how satisfied are you with your relationship with our firm?
5. What's most important to you in terms of your relationship with our firm?
6. More specifically, how satisfied are you with the performance of the following individuals at our firm? *[Firm note: include all client touch points – partners, professional staff, administrative staff, etc.]*
7. Looking at other areas, how satisfied are you with each of the following: accuracy of our services, performance of our services, accuracy of our invoices, responsiveness to inquiries, follow up with you on your changing needs, the number of services we offer, the types of services we offer, our service fees, accessibility of our staff?
8. Are you aware of the full range of services our firm provides?
9. Through which communications channels do you most prefer to work with our firm?
10. In the past year, how many times have you visited our firm's website?
11. How important is it to you that you have direct access to your information as a client of our firm, through something such as a client portal?
12. Which types of information we provide to you do you find most valuable?
13. Over the next year, is the amount of support you will need from our CPA firm likely to increase, decrease or stay about the same?
14. What are the most critical challenges you face over the coming year?
15. Which services do you expect you will need in the coming year? *[Firm note: make certain to list all the services you currently offer, as well as those you may be considering adding.]*
16. How likely are you to recommend our firm to someone else?
17. How likely are you to switch CPA firms in the coming year?
18. What are the primary considerations that would make you consider switching CPA firms?
19. Which best describes our firm to you: we are a valued business partner or we are a vendor that provides tactical support to your requests?
20. How satisfied are you with the service value you receive from our CPA firm for the price you are charged?

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