Non-qualified 401(k) Look-Alike Plans with Life Insurance

The opportunity is BIG.
The time is NOW.
And the place is ING.

Producer Guide

This material is not intended to and cannot be used to avoid tax penalties. It was prepared to support the promotion or marketing of the matters addressed in this document. Each taxpayer should seek advice from an independent tax advisor. The ING Life Companies and their agents and representatives do not give tax or legal advice.

LIFE

ING

Your future. Made easier.®

For agent/registered representative use only. Not for public distribution.

Reward Top Talent with a Non-qualified 401(k) Look-Alike Plan

In today's market, it's important to recruit and retain top executive talent to ensure the growth and long term success of a business. One way employers can do this is by offering benefits that address a key concern of management and highly compensated employees—retirement planning.

Employers turn to non-qualified deferred compensation plans as an executive benefit because the Internal Revenue Code (I.R.C.) and the Employee Retirement Income Security Act of 1974 (ERISA) place restrictions on "qualified plans."* For example, qualified plans must meet stringent nondiscrimination, participation, vesting and reporting requirements. Additionally, such plans often do not provide equitable treatment for highly compensated employees because statutory limits cap the amount that can be contributed to the plan creating "reverse discrimination." Thus non-qualified plans can be an attractive alternative for rewarding valuable executives who wish to set aside additional income for retirement.

Non-qualified 401(k) Look-Alike Plans

One type of non-qualified plan finding favor in the corporate market today is the Non-qualified 401(k) Look-Alike Plan with Life Insurance. Like its qualified counterparts, a Non-qualified 401(k) Look-Alike plan is an employer-sponsored plan that allows executives to make voluntary deferrals on a pretax basis with some type of employer matching credit. The adoption of a 401(k) Look-Alike plan allows the employer to provide executives with a way to:

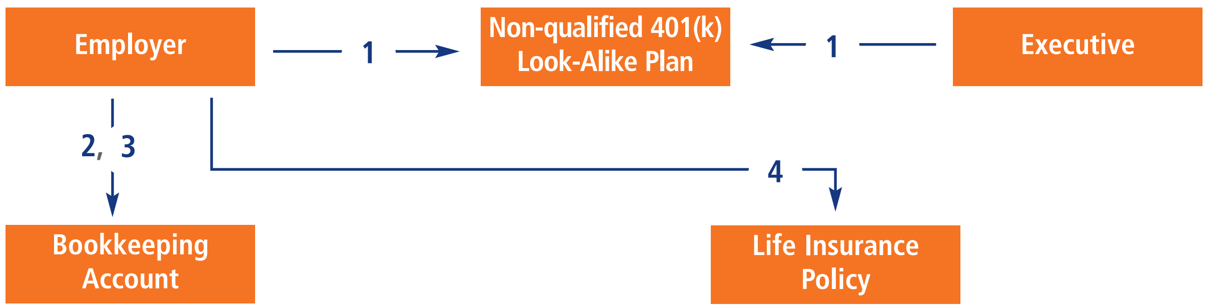
- Reduce current taxable income
- Establish a savings and/or retirement fund with life insurance
- Enable retirement savings to grow on a tax-deferred basis
- Tailor the plan investments to help meet personal goals.

* A "qualified plan" means an employee benefit plan meeting the requirements of Internal Revenue Code Section 401.

How a 401(k) Look-Alike Plan with Life Insurance Works

A 401(k) Look-Alike plan is a variation of a true deferral plan, where an executive elects to defer income earned. The deferral election must be made before the income is earned and the time and manner of payment for the deferral must meet the requirements of IRC § 409A. With a 401(k) Look-Alike plan, the executive elects to defer income and the employer may agree to match all or a portion of the deferral. Here's how it works:

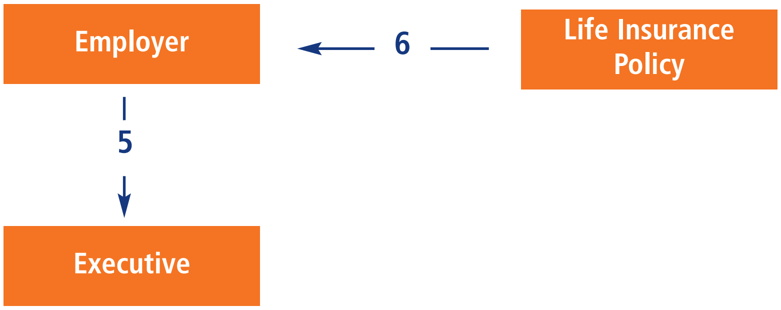
While the Executive is Employed



1. The employer and the executive enter into a contractual arrangement to defer future compensation under the non-qualified 401(k) Look-Alike plan. The terms of the plan are documented.
2. Each calendar year the executive elects to defer a portion of current compensation prior to the period of service in which the compensation will be earned. The employer has the right to set limits on the deferral amount.
3. The employer matches all or a portion of the executive's deferral according to a prearranged formula. For example, the employer may agree to match a certain percentage of the executive's deferral, up to a set maximum. Deferrals, matching employer credits and earnings are periodically credited to a bookkeeping account in the executive's name.
4. The employer purchases a key person life insurance policy on the executive's life. The policy serves as an informal funding vehicle for the benefit liability.

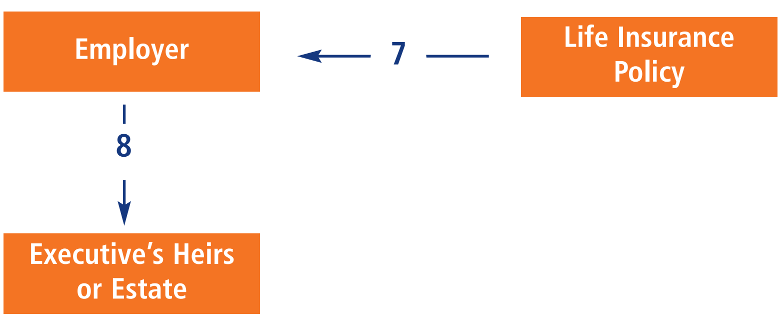
At the earlier of retirement, termination, death or disability, a benefit is paid to the executive (or heirs) in an amount that generally reflects the balance in his or her bookkeeping account.

When the Executive Retires



5. The employer pays the promised retirement benefit.
   - The payment is deductible by the employer (assuming compensation is reasonable).
   - The retirement benefit is taxable compensation to the executive.
6. With proper design, the benefits can be paid using income tax-free withdrawals to basis and loans from the informal funding vehicle, the life insurance policy. Income tax-free distributions are achieved by withdrawing to the cost basis (premiums paid) then using policy loans.[1] Alternatively, the employer can pay the liability from current earnings and recover the cost of the plan upon receipt of the death benefit.

If the Executive Dies Prior to Retirement



7. The policy pays an income tax-free death benefit to the employer, which may be subject to the corporate Alternative Minimum Tax (AMT).[2]
8. The employer pays any benefit owed to the executive's heirs. This payment is deductible by the employer and is taxed as ordinary income to the heirs. Compensation which was earned by the decedent but not included in his taxable income for the year of death is taxable income in respect of a decedent (IRD).

[1] Policy loans and partial withdrawals may vary by state, reduce available surrender value and death benefit or cause the policy to lapse. Generally, policy loans and partial withdrawals will not be income taxable if there is a withdrawal to the cost basis (usually premiums paid), followed by policy loans (but only if the policy qualifies as life insurance, is not a modified endowment contract and is not lapsed or surrendered).

[2] For policies issued after August 17, 2006, IRC § 101(j) provides that death benefits from an "employer-owned life insurance contract" are income taxable in excess of premiums paid unless an exception applies and certain notice and consent requirements are met before the policy is issued. Please consult your tax or legal advisors for more information.

Advantages of a 401(k) Look-Alike with Life Insurance Plan

Both the employer and the executive receive a number of benefits from this type of properly structured non-qualified plan.

For the Employer

- Enhances the business' ability to attract and retain talented executives.
- Can be implemented with a qualified plan in place or used on its own.
- Offers an alternative to the stringent I.R.C. requirements applicable to qualified plans.
- When properly structured, requires only simplified ERISA reporting.
- Subject to ERISA requirements, allows the discretion to choose which executives may participate.
- Provides design flexibility.
- The cash values of the employer-owned policy have the potential to grow tax-deferred and are general assets of the employer, which can be accessed by the plan sponsor through loans and withdrawals when the need arises.[3]
- The employer-owned policy can be designed to provide cost recovery through the income tax-free death benefit.[4] This benefit may be subject to the corporate Alternative Minimum Tax (AMT).

For the Executive

- Executives can defer compensation in excess of qualified plan limitations.
- Assuming the plan is structured to comply with I.R.C. § 409A, executive deferrals and employer matching credits are not taxed until distributions are made.
- Executive deferrals can be paid on an income tax-deferred basis.
- Employer matching credits help boost the non-qualified retirement account.
- Early distributions to the executive are not allowed except under stated conditions. These conditions are: court order, death, disability, unforeseeable emergency, separation from service (six months after for public companies) or change in ownership control.
- Plan designs can be created with a survivor benefit.

[3] Policy loans and partial withdrawals may vary by state, reduce available surrender value and death benefit or cause the policy to lapse. Generally, policy loans and partial withdrawals will not be income taxable if there is a withdrawal to the cost basis (usually premiums paid), followed by policy loans (but only if the policy qualifies as life insurance, is not a modified endowment contract and is not lapsed or surrendered).

[4] Death proceeds from an insurance policy are generally income tax free (e.g., absent a transfer for value). For policies issued after August 17, 2006, IRC § 101(j) provides that death benefits from an "employer-owned life insurance contract" are income taxable in excess of premiums paid unless an exception applies and certain notice and consent requirements are met before the policy is issued. Please consult your tax or legal advisors for more information.

Documenting the 401(k) Look-Alike with Life Insurance Plan

Generally, the employer uses a formal "resolution" approved by the Board of Directors to establish that selected executives will be offered the opportunity to participate in a salary reduction deferred compensation arrangement where the employer agrees to credit a matching salary credit as set forth in a plan document. This plan document generally addresses, at a minimum, the following areas:

- Executive deferral rights
- Employer matching responsibilities
- The definition of salary
- An outline of what happens to the executive's benefits in the event of disability, termination, death, retirement, hardship, etc.

Although many sample documents are available, they should only be used as general representations of the issues to be addressed and the documentation required in various situations. It is important that the final plan document be designed and reviewed by the employer's legal and tax counsel.

"Election to Participate" forms need to be distributed to all executives eligible for the plan. Executives who agree to participate must elect to defer income before the end of the tax year.

Income Tax Consequences For the Executive

One of the primary design goals of a 401(k) Look-Alike plan is for the participants to avoid current taxation of deferrals and matching credits as well as defer any taxation of earnings on these amounts. The objective is to defer the income tax liability until distributions are actually received by the executive. Before looking at other design considerations, let's examine a basic tax rule.

One simple yet effective rule can help avoid loss of tax deferral for the executive:

- **Vested But Unfunded:** If the plan is an unsecured and unfunded promise (i.e. participant has no preference over the employer's general creditors) to pay benefits to the participant in the future, the participant, whether partially or totally vested, will not be taxed currently under the plan.

The above rule is a short synopsis of the tax doctrine that the participant must avoid to achieve tax deferral on the sums in his or her account: constructive receipt and economic benefit.

The constructive receipt doctrine is used to currently tax cash basis taxpayers on income that is made available to them even if they have not actually received it. If the executive's right to the deferred compensation is forfeitable, there is no constructive receipt. Even where the executive's rights are nonforfeitable (vested), there will be no constructive receipt provided that (1) the deferral contract is entered into before the services are performed, (2) the employer's promise to pay is not secured in any way, and (3) the plan's terms comply with the requirements of I.R.C. § 409A. For the employer's promise to be unsecured, the plan must be considered unfunded. That is, the plan assets must be general assets subject to the claims of the employer's creditors.

While constructive receipt deals with the receipt of income, the economic benefit doctrine deals with the receipt of property rights under I.R.C. §83. The economic benefit doctrine will likely apply if the employer's liability to pay the deferred compensation is funded and the executive acquires an interest in the funding vehicle. Section 83 of the Internal Revenue Code excludes unsecured and unfunded promises to pay from the definition of property, thus providing another escape hatch for non-qualified deferral plans. If the non-qualified plan is funded, then it is important that a "substantial risk of forfeiture" is included or the executive will be subject to immediate income taxation.

In addition to the constructive receipt doctrine and the economic benefit doctrine, Internal Revenue Code Section 409A imposes another layer of tax law that expands these doctrines. Under these rules, a deferred compensation plan must provide that any compensation deferred can only be paid under the occurrence of specified events such as separation from service, disability, death, a specified time or pursuant to a fixed schedule, a change in control or an unforeseen emergency. Generally, deferred amounts may not be accelerated and special rules apply to deferral elections.

When the retirement benefits are actually paid to the executive or he or she is in constructive receipt with no substantial risk of forfeiture and assuming the plan complies with I.R.C. 409A, then income taxation will occur. Retirement benefits are a form of compensation and will be taxed as ordinary income.

Income Tax Consequences for the Employer

Just as the executive's income tax liability is deferred, the employer is not permitted a deduction for the deferred amounts and matching credits until they are included in the executive's income. This is true even if the executive's rights under the plan are vested. When the benefit payments are includible in the executive's income, then the employer may deduct the payments, provided they meet the criteria for reasonable compensation.

When life insurance is used as an informal funding vehicle for a 401(k) Look-Alike plan, the premiums paid on the key employee contracts will not be deductible by the employer because the employer directly (or indirectly) benefits from the policies.

Eligible Participants and ERISA Rules

The Non-qualified 401(k) Look-Alike plan generally specifies the eligibility requirements for an executive to participate in the plan. The most common requirements are salary, position and years of service. Often, participants are selected at the sole discretion of the Board of Directors.

Whichever approach is used, it is important to remember that non-qualified plans are generally pension plans for ERISA purposes. Unless carefully constructed to be exempt from ERISA, these plans will be subject to the compliance requirements of Title I. Adherence to these requirements is burdensome, time consuming and costly. In addition, a non-qualified plan, if required to meet the minimum funding, vesting and fiduciary trust requirements found in Title I, will be considered funded for IRS purposes. As a funded plan, executives lose the advantage of income tax-deferral unless their right to receive benefits is not transferable and is subject to a substantial risk of forfeiture.

Absent an exemption from ERISA compliance, most employers would tend to shy away from maintaining a Non-qualified 401(k) Look-Alike plan. Fortunately, ERISA provides two exemptions for Non-qualified 401(k) Look-Alike plans designed as top-hat plans or excess benefit plans.

Top-Hat Plan

Unfunded top-hat plans, designed to provide benefits to a "select group of management or highly compensated employees" are excluded from most of the Title I ERISA requirements for non-qualified plans. Properly structured, top-hat plans are exempt from Parts 2, 3 and 4 of Title I of ERISA. In addition, the plan administrator can meet the requirements of Part I through a simplified reporting procedure.

- **Select group:** The definition of a "select group" is not clear. The Department of Labor (DOL) has taken a restrictive view limiting it to executives who appear not to need the protection afforded by ERISA. This implies that these executives have some degree of control over, or input into, the business entity's decision-making process that the average employee lacks.

  The courts have taken their own path regarding the interpretation of this phrase and tend to examine the facts, circumstances and purposes of each benefit arrangement to determine whether a plan constitutes a top-hat plan under ERISA. Despite numerous cases, no clear fact pattern has emerged as a safe harbor.

- **Highly compensated employees:** Again, the DOL's position on the interpretation of this term is unclear. It is not safe to assume that the definition of a highly compensated employee found in I.R.C. §414(q) can be used to define the members of a top-hat group for ERISA purposes. This definition of highly compensated—salaries in excess of $110,000 (in 2009 as indexed)—is intended as a directive for qualified plans. This arbitrary number does not take into account the relative pay level or the management responsibilities of so-called highly compensated as compared to other employees. In addition, the preamble to the regulations of this section states the Treasury Department and DOL agree the definition of a highly compensated employee under the Code does not determine highly compensated status under Title I of ERISA.

It's to the employer's advantage to develop a justification for those executives included in the top-hat plan. Listed below are some common approaches:

- **Selected individuals:** Participants selected by the employer are both management and highly compensated individuals.
- **Selected office holders:** Participants must hold high level offices within the organization.
- **Selected highly compensated individuals:** Participants need to be earning in excess of a certain compensation level. The established dollar level should be sufficiently high in relation to the general work force to satisfy top-hat criteria.

In view of all the uncertainties, it is important that ERISA counsel and tax counsel be consulted before implementing a top-hat plan, especially when the plan covers a relatively large, more inclusive group of management.

Excess Benefit Plan

An excess benefit plan is a non-qualified plan designed to restore those retirement benefits lost by a company's key executives due to the application of the I.R.C. §415 limits on contributions and benefits under qualified plans.

Under ERISA §4(b)(5), an unfunded excess benefit plan is exempt from all requirements of ERISA Title I.

ERISA §3(36) defines an excess benefit plan as: "A plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by I.R.C. §415…."

The DOL has not provided any guidance with respect to the meaning of the term "solely." To protect the status of an excess benefit plan, the purpose of such a plan should be to provide benefits in excess of the I.R.C. §415 limits. If the plan provides any other benefits or takes into account other limitations under the code, it may not qualify as an excess benefit plan for ERISA purposes. If the plan fails to qualify as an excess benefit plan, it may be reclassified as a top-hat plan. However, even when the plan meets the top-hat criteria, problems can arise if the plan has not satisfied the applicable ERISA reporting and disclosure requirements.

Compensation Defined

Depending on the goals of the employer and the executive, compensation can be defined broadly or narrowly.

- **Broad definition of compensation:** Includes all wages, salaries, overtime, bonuses, commissions and other amounts received for personal services rendered in the course of employment.
- **Narrow definition of compensation:** Limits what is considered compensation. For example, includes only base wages or base wages plus bonuses.

If a narrow definition of compensation is used, the participant's ability to shield income from current taxation through deferrals is reduced. Conversely, the employer reaps a positive economic effect because greater compensation is immediately deductible.

Deferrals and Matches

Limits on Executive Deferrals

Executive deferrals might be limited to:

- A flat percentage of salary with a cap.
- A percentage of salary increasing with time or service with a cap.
- A flat dollar ceiling.
- A dollar ceiling increasing with time or service.

Defining Employer Matching Credits

Employer matching credits may be defined as:

- A percentage of compensation with a cap.
- A fixed percentage of the amount deferred.
- A fixed dollar cap.
- A percentage that reflects the terms of an existing qualified plan.
- A uniform amount; that is, the same match for all executives.
- A discriminatory amount; that is, different levels of matching for different executives.

Formulas for Crediting Earnings to the Participants' Accounts

Voluntary deferrals, matching employer credits, and earnings are credited to the "participant's account," which is simply a bookkeeping account. Since the participant's account is not an actual investment account, the plan needs to provide a formula for crediting earnings. Examples of such formulas include:

- **Fixed rate of return:** This is the simplest approach. The employer provides for a fixed percentage to be credited to the participant's account.
- **Index-driven formula:** The employer could make a yearly allocation to the account based on an interest formula tied to business performance or a specific market index, such as the Standard & Poor's 500.
- **Participant-driven investment choices:** Even though flat rate or indexed designs are easy to implement, an employer often likes to offer its executives a plan with investment alternatives similar to those in its qualified 401(k) plan. Executives who participate in top-hat plans are usually sophisticated, knowledgeable and willing to assume an investment risk to reap greater retirement rewards. As a result, a new crediting approach has become popular: participant-driven investment choices.

  Different scenarios are available for this approach, but generally it works something like this: under the plan, participants choose one or more phantom investment funds as a measure of the amounts to be credited to their account balances. The participant's account balance is credited "as if" he or she had invested directly in these phantom investment choices. However, there is no actual money invested, because this is an unfunded non-qualified plan. The participant's account is only a bookkeeping account that "mirrors" the performance of the phantom investment choices, not an investment vehicle.

  It is important to note that the executive should not be given actual investment authority or the constructive receipt doctrine could apply and result in immediate income taxation. In addition, the plan would be deemed "funded" and subject to all the requirements of Title 1 of ERISA. The IRS has indicated that if the employer is not required to follow the directions of the employee and has full control and discretion over crediting earnings or making investment decisions regarding any "informal funding" arrangement, no adverse tax consequences should occur.

Vesting* Schedules

Vesting represents the nonforfeitable interest of participants in their accounts. The executive is always 100 percent vested in his or her own deferrals and earnings. The employer may create "golden handcuffs" by subjecting its matching credits to some type of vesting schedule. If the executive leaves the firm before a specified time period, he or she loses all or a portion of the employer match and the earnings on this match.

Depending on the employer's goals, this vesting schedule can be structured narrowly to favor the employer or generously to reward the executive. Two common vesting schedules are:

- **Five-year cliff vesting (favors the employer):** The executive becomes 100 percent vested after he or she is credited with five years of service. Prior to the fifth year, the vesting percentage is zero.
- **Five-year graded vesting (favors the executive):** The executive becomes 100 percent vested after he or she is credited with five years of service. Gradual vesting percentages apply prior to the fifth year.

The chart below shows typical vesting schedules (percentages)

Years of Service	Percent Vested
One Year	20 percent
Two Years	40 percent
Three Years	60 percent
Four Years	80 percent
Five Years	100 percent

Informally 'Funding' Plan Obligations

The participants' account balances represent a future liability for the employer. The employer must make certain there will be adequate working capital available to pay the benefit obligations as they come due. A prudent employer may anticipate this need and informally "fund" the obligation. Since "funding" is directly tied to tax deferrals for the executive, it's important to understand how it can be structured.

- **Completely unfunded:** The employer sets no funds aside. This type of approach is appealing to some employers because cash is not tied up in an investment but remains available for ongoing business needs. The downside is that this "pay-as-you-go" approach offers the executive little assurance that the employer will be able to make the promised payments. In addition, future managers are left paying the obligation for executives who may have never contributed to current profits.
- **Informally funded:** Confusion exists about the meaning of this term. In a non-qualified plan, the employer sets aside assets as a targeted source of income from which to pay its promised benefits. If these assets remain available to the employer's general creditors, the plan will be considered unfunded for both ERISA and IRS purposes.

An employer can facilitate payment of benefits by maintaining a reserve account in which funds are fully accessible to the employer and its creditors, purchasing employer-owned life insurance on the lives of the key executives or establishing a rabbi trust.

To achieve the desired income tax and ERISA consequences, the plan needs to be unfunded or informally funded. If the employer truly funds the plan (i.e. uses an escrow fund, a secular trust, or a guarantee in which the executive has an interest) the executive is no longer at risk for the sums in the account. Unless the account is subject to a substantial risk of forfeiture, immediate income taxation will result for the executive.

* Vesting represents a contractual right to receive payments under the terms of the plan and does not represent any contractual rights to any other property or fund.

Informal Funding Alternatives

When the employer determines that assets should be set aside to informally fund the benefit obligation, an investment strategy that meets the financial needs of the business and is designed to help ensure that the benefit funds will be available for future payout needs to be developed. Financing alternatives include mutual funds and other equity investments or life insurance.

Mutual Funds and Other Equity Investments

Mutual funds are probably the most popular investment choice for qualified 401(k) plans. The major funds have performance information readily available and appeal to most employers and executives. One disadvantage to the use of mutual funds and other equity investments in a 401(k) Look-Alike plan is that, as a shadow investment owned by the employer, the employer will be taxed on any investment gains and dividends received that are not tax exempt. This liability needs to be considered in any economic analysis of the 401(k) Look-Alike plan.

Life Insurance

As with mutual funds (and other equity based investments), the use of life insurance has its advantages and disadvantages. Some disadvantages include the administrative fees and mortality expenses. However, an advantage to informally funding a 401(k) Look-Alike plan with life insurance is that it provides the following benefits to both the employer and the employee:

- The life insurance serves as a sinking fund to informally fund the employer's obligation.
- The policy's cash value is shown as an asset on the employer's balance sheet.
- All interest credited to the policy's cash value is accumulated on an income tax-deferred basis. If the policy is surrendered before death, and the amount received is greater than the employer's basis in the policy, the gain in the contract will be subject to income tax.
- Cash value can be accessed through a combination of withdrawals and policy loans that, if properly designed, can be income tax free, assuming the policy is kept in force until the insured's death. Under this assumption, income tax-free distributions are achieved by withdrawing to the cost basis (premiums paid) then using policy loans.[5]
- The employer receives death benefit proceeds income tax free.[6]

Here's how it works: The employer purchases life insurance on the lives of each of the executives. The employer pays the premium and is the owner and beneficiary of the policies. The executives have no rights in the policies. The policies can be designed with sufficient cash value to potentially reimburse the employer for the after-tax cost of each executive's retirement benefits. This cost to the employer includes: the taxes paid on the executives' deferrals as a result of the lost compensation deduction (recovered when the benefits are paid), company matches, the after-tax interest credited on the deferrals and matches, and perhaps, a factor for the time value of money.

Retirement benefits may be paid using the policy's cash value through properly designed partial surrenders, withdrawals and/or loans. Or, the employer may pay benefits from current profits, waiting to recover plan costs from the death benefit proceeds. In this manner, the employer achieves an immediate tax deduction upon the distribution and also defers any gain that would be taxable if the policy were surrendered.

[5] Policy loans and partial withdrawals may vary by state, reduce available surrender value and death benefit or cause the policy to lapse. Generally, policy loans and partial withdrawals will not be income taxable if there is a withdrawal to the cost basis (usually premiums paid), followed by policy loans (but only if the policy qualifies as life insurance, is not a modified endowment contract and is not lapsed or surrendered).

[6] Death proceeds from an insurance policy are generally income tax free (e.g., absent a transfer for value). For policies issued after August 17, 2006, IRC § 101(j) provides that death benefits from an "employer-owned life insurance contract" are income taxable in excess of premiums paid unless an exception applies and certain notice and consent requirements are met before the policy is issued. Please consult your tax or legal advisors for more information. Additionally, death benefits received by a C corporation may subject the corporation to the Alternative Minimum Tax.

Product Features

The life insurance product chosen to fund a particular 401(k) Look-Alike plan will depend on the needs and circumstances of the employer. There are a variety of insurance contracts and product features from which to choose to meet the employer's objectives. The type of contract chosen will depend upon the plan objectives and other circumstances (executives' ages, years to retirement, etc.).

Term contracts are generally used when an employer has limited current cash flow, but some informal funding is needed because the plan contains some survivor benefits.

Cash value life insurance is normally used when the objective is to build a real informal cash asset reserve. Here, products that are more cash intensive or investment oriented may be desirable.

The following product features help maximize the contract's cash value for the plan's objectives:

- **Long-term performance:** Substantial cash buildup to provide a larger source of informal funds is the objective. Whether traditional, universal or variable contracts* are used, competitive crediting rates, low mortality charges and low expense loads are needed to maximize cash growth.

  * Variable products do not have crediting rates.

- **Near-zero net-interest-cost loans and zero net-interest-cost loans:** If the interest rate credited on borrowed funds is close to or the same as the interest rate charged for the loan, the interest earned covers the majority of or all of the interest paid. Thus, the employer gets a near-zero net-interest-cost loan or a zero net-interest-cost loan, making this a more economical way to fund the plan if policy loans are used to pay retirement income.

- **Flexibility:** Because an executive's deferral and an employer's matching credits to the plan may fluctuate from year to year, a universal life policy may be the answer, as it allows the employer to have the ability to start, suspend or adjust premiums (as long as there is sufficient cash value to keep the policy in force).

Variable Universal Life Insurance

Variable universal life insurance contracts have become increasingly popular among both plan designers and employers because of their ability to support 401(k) Look-Alike plans by providing variable investment options to the participants in the plan. When variable universal life insurance is used by an employer as an informal funding vehicle for a 401(k) Look-Alike plan, the employer can pick and choose variable investment options to match the performance of the executives' phantom investment choices. Variable investment options are only available as investment options in variable universal life insurance policies and variable annuity contracts issued by life insurance companies. They are not directly offered or made available to the public.

Features found in variable products (that may also be available with mutual funds) that allow the employer a greater degree of direction over potential cash value growth are:

- **Dollar cost averaging:** By using automatic monthly transfers of a fixed dollar amount to designated variable investment options in the variable policy, the employer can reduce the risk of investing too much when the price of variable investment options is too high and too little when the price of the variable investment options is low. Investing regular amounts at regular intervals historically has resulted in a lower out-of-pocket cost per share over time. However, it does not ensure a profit and does not guarantee against loss in a declining market.

- **Automatic rebalancing:** Using this feature, the employer can ensure that a balanced approach to values is maintained because balances are automatically adjusted to reflect current premium allocation percentages on a periodic basis. This simplifies the process of asset allocation, helping the employer maintain the desired risk profile.

  The ultimate value of the variable investment options at death or retirement is not guaranteed and will be based on investment performance of the variable investment options. While the variable investment options may provide a hedge against inflation and the possibility for growth in both cash reserves and death benefits, there is a risk that investment performance will be poor and the cash value will decrease or be lost.

- **Planning ideas:** Like every insurance product, a variable policy includes mortality charges, commissions, administrative costs, and potential surrender charges if the policy is canceled during a specific period of time. The issue for the employer is how to minimize these costs and effectively use the death benefit.

  One solution is to choose a variable universal life insurance product designed to maximize the portion of the premium payments that go directly into the variable investment options and minimize administrative and surrender charges.

  Or, by tying the use of vesting schedules for the employer's matching amounts to the set time period when surrender charges occur, it is possible to design a plan so that the employer will not incur any additional cash outlay for an early distribution to an executive. For example, an executive might be prohibited from separating from the 401(k) Look-Alike plan for a specific number of years, even if the executive leaves the employer. Alternately, the employer may seek to minimize costs by more effectively combining death benefit needs within the organization.

Securing the Liability

Because non-qualified plans must be either unfunded or informally funded, executives may be concerned about the security of the promised benefits. In particular, executives may be concerned that the employer will either be unwilling or unable to pay the benefits when promised. To address these concerns, special trusts have been developed to provide additional security to executives.

Rabbi Trust (no offshore)

A rabbi trust is an irrevocable grantor trust established to accumulate money and assets to be used to informally fund the employer's obligation. The executive is protected from the employer's unwillingness to pay benefits because the assets in the trust are protected from employer invasion and takeovers. However, executives are not protected in the event of an employer's bankruptcy or insolvency since the assets in a rabbi trust remain exposed to the employer's general creditors. The funds in a rabbi trust remain at risk; therefore, the executive may continue to defer taxation on these amounts.

Secular Trust

The secular trust is a funded, irrevocable trust that secures the employer's promise to pay by placing the benefit funds beyond the reach of the employer's creditors. Unlike a rabbi trust, a secular trust protects the executive from both an employer's future unwillingness or inability to pay promised benefits. However, there is a trade-off for this additional security. The executive is subject to current income taxation because this will be considered a funded plan for tax purposes. The employer will receive a current deduction as long as the compensation is considered reasonable.

Rabbicular Trust [7]

In the past, some financial professionals have used a springing rabbi trust or "Rabbicular" trust to provide additional security to a rabbi trust while still allowing executives to defer taxation. These trusts were like rabbi trusts in that assets placed in the trust were protected from the employer but still subject to the claims of the employer's general creditors. Rabbicular or springing rabbi trusts, however, would also include triggers (such as decline in stock price or financial losses) that would cause the trust to automatically convert from a rabbi trust to a secular trust (at which time the executive would be taxed on assets accumulated for his or her benefit). Under the new rules of IRC § 409A, Rabbicular or springing rabbi trusts are no longer permitted for non-qualified plans

Coordinating with the Qualified Plan

Often an employer wants a 401(k) Look-Alike plan to be integrated with a qualified 401(k) plan so that executives who are adversely affected by mandated qualified plan limitations may defer excess contributions directly to the 401(k) Look-Alike plan. Prior to the Health Insurance and Welfare Reform Act of 1996, the permitted deferral election could only be calculated near plan year end, at which time it would be too late to coordinate these sums with any non-qualified deferrals.

To circumvent this problem, design solutions known as "wrap-arounds" or "tandem plans" arose that allowed pour-over of excess contributions between the qualified and non-qualified plans. Uncertainty existed as to the IRS' treatment of this pour-over amount and whether the executive could lose tax deferral as he or she was considered to have constructive receipt of these sums. In 1995, the IRS indicated its approval (PLR 9530038) of a wrap plan where the entire deferral was initially placed in the non-qualified plan and then the proper amount was later transferred to a qualified 401(k) plan. Additional confirmation of this technique is found in PLR 9752018, where the IRS approved a very similar plan.

[7] The term "Rabbicular Trust" is a service trademark of Michael G. Goldstein, J.D., LL.M, St. Louis, Missouri, 1994.

There is some question, however, as to how "wrap-around" or "tandem" plans will be treated under IRC § 409A. The IRS has indicated that an executive's ability to re-allocate hypothetical investments or to tie distributions from the non-qualified arrangement to the timing of distributions under a qualified 401(k) plan may cause the arrangement to violate § 409A.

Administrative Requirements

Plan Administration

While 401(k) Look-Alike plans offer additional planning flexibility by allowing pretax deferrals to be invested in different phantom investments, employers need to recognize that this flexibility has a price—additional administrative requirements. The lack of a direct link between an executive's deferrals and the underlying phantom assets presents a unique set of record-keeping problems. Any system used for the 401(k) Look-Alike plan must be able to track holdings, credit earnings and distributions even though no actual assets back the executives' accounts. In addition, when life insurance serves as the informal funding vehicle, policies must be monitored to ensure that the increasing benefit obligation is being adequately tracked and offset by the policy's cash values. Often these types of plans require the systems and knowledge of a third-party plan administrator. ING life insurance companies do not perform third-party administrator functions for qualified or non-qualified plans.

Accounting Principles

All Non-qualified 401(k) Look-Alike plans, whether informally funded with life insurance or not, must be recorded in the employer's financial records using specific accounting rules known as Generally Accepted Accounting Principles (GAAP). The benefit liability and the insurance asset are treated separately under standards set forth by the Financial Accounting Standards Board (FASB). The benefit obligation is recognized as a liability under SFAS No. 106, Employers' Accounting for Post-retirement Benefits Other Than Pension. Technical Bulletin 85-4, Accounting for Purchases of Life Insurance, details the accounting treatment of corporate owned life insurance. In addition, SFAS No. 109, Accounting for Income Taxes, addresses the accounting treatment of deferred taxes for both corporate owned life insurance investments (if any) and the deferred compensation liability.

Income Tax Withholding and FICA/FUTA

Amounts in a 401(k) Look-Alike plan are subject to federal income tax withholding when they are included in the executive's gross income for federal income tax purposes.

In general, an executive's interests in a Look-Alike plan are included in FICA/FUTA wages and become subject to FICA/FUTA taxes when paid or constructively received by the executive. There is also a special timing rule that has the effect of accelerating social security taxes on the executive's interests. Under the special timing rule the executive's interests become subject to FICA/FUTA taxes as of the later of (1) when the services relating to the interests are performed or (2) when there is no substantial risk of forfeiture of the rights to the interests. A substantial risk of forfeiture exists where benefits are conditioned upon either (1) the future performance or nonperformance of substantial services by any person or (2) the occurrence of a condition related to a purpose of the transfer.

Basically, these rules provide that in the case of a deferred compensation plan that maintains separate account balances (a defined contribution plan such as the 401(k) Look-Alike plan), and which also provides for nonforfeitable plan benefits, the executive's interests will be subject to FICA/FUTA tax annually as earned.

The employer is permitted to wait until the last day of the year to withhold and pay FICA/FUTA taxes unless the executive has received a lump sum distribution relating to termination of employment. If the employer is unable to readily calculate the amounts of the executive's interests that became nonforfeitable during the year by December 31, the employer can use either an estimated method for withholding or a "lag method," whereby the actual calculation and withholding is completed during the first quarter of the following tax year.

It is also important to note that when retirement benefits from the 401(k) Look-Alike plan are paid to the executive, these benefits will not be subjected to FICA/FUTA taxes again, nor will they cause any reduction of social security benefits.[8]

Federal Estate Taxes

Any amount payable to a beneficiary under a 401(k) Look-Alike plan is includible in the executive's estate. Payments by the employer to the executive's beneficiaries are income in respect of a decedent (IRD) and are taxed as they would have been for the executive; as compensation treated as ordinary income. The beneficiary should be entitled to a miscellaneous deduction for any estate taxes paid due to the Look-Alike plan.

ERISA Requirements

When the top-hat exemption is met, the plan will be exempt from most ERISA provisions. However, the plan must provide for a plan administrator and identify a claims procedure. The plan administrator must, within 120 days of plan inception, file a short written notice with the Secretary of Labor. Failure to meet this deadline means the plan is probably obligated to comply fully with all the reporting and disclosure requirements of Title I, Part 1, of ERISA.

Want to Hear More?

For top notch sales support from leading industry professionals dedicated to helping you grow your life business, call ING Life Sales Support at 866-ING-SELL (866-464-7355, option 4).

[8] §203(f)(5)(C) of the Social Security Act of 1935, as amended.

ReliaStar Life Insurance Company
20 Washington Avenue South
Minneapolis, MN 55401

ReliaStar Life Insurance Company of New York
1000 Woodbury Road, Suite 208
Woodbury, NY 11797

Security Life of Denver Insurance Company
1290 Broadway
Denver, CO 80203

Log in to ING for Professionals at www.inglifeinsurance.com

The ING Life Companies and their agents and representatives do not give tax or legal advice. This information is general in nature and not comprehensive, the applicable laws change frequently and the strategies suggested may not be suitable for everyone. Clients should seek advice from their tax and legal advisors regarding their individual situation.

These materials are not intended to and cannot be used to avoid tax penalties and they were prepared to support thepromotion or marketing of the matters addressed in thisdocument. Each taxpayer should seek advice from an independent tax advisor.

Life Insurance products are issued by ReliaStar Life Insurance Company, ReliaStar Life Insurance Company of New York, and Security Life of Denver Insurance Company. Variable life products distributed by ING America Equities, Inc., 1290 Broadway, Denver, CO 80203. Within the state of New York, only ReliaStar Life Insurance Company of New York is admitted, and its products issued. All are members of the ING family of companies.

Before investing, your clients should carefully consider their need for life insurance coverage and the charges and expenses of the variable universal life insurance policy. They should also consider the investment objectives, risks, fees, and charges of each underlying variable investment option. This and other information is contained in the prospectuses for the variable universal life insurance policy and the underlying variable investment options. Clients may obtain these prospectuses from you, by calling 877-253-5050, or from and should read them carefully before investing.

Variable insurance products are offered by prospectus only. To solicit variable insurance products you must maintain a variable insurance license and be a registered representative of a broker-dealer that has a current selling agreement with the issuing company.

cn35944072011

For agent/registered representative use only. Not for public distribution.

The opportunity is **BIG.**
The time is **NOW.**
And the place is **ING.**

ING

116712 07/31/2009