

Retirement Plan Overview

There are several types of qualified plans that can meet your needs. A retirement plan can serve many purposes, from attracting and retaining quality employees, to tax sheltering income.

The following is general information about some of the most popular types of retirement programs. Our consultants, along with a third party administrator, can help you choose and design the plan that is best for you and your employees.

Qualified Retirement Plans in General

A qualified plan must meet a certain set of requirements in the Internal Revenue Code such as minimum participation, vesting and funding requirements. In return, the IRS provides tax advantages to encourage businesses to establish retirement plans.

Sponsoring a well-designed qualified retirement plan will:

- Attract experienced employees
- Motivate and retain quality employees
- Help employees save for their future

Employers can choose between two basic types of qualified retirement plans:

- Defined Contribution
- Defined Benefit

Defined Contribution Plans

A defined contribution plan defines the contribution the employer will make to the plan and how the contribution will be allocated among the eligible employees. A separate account is maintained for each participant. The participant's account balance grows through employer contributions, employee contributions (if permitted), and investment earnings.

Since contributions and investment results vary from year to year, the ultimate retirement benefit cannot be predicted. The actual benefit will be based on the amount in the participant's account at the time the distribution is made.

Profit Sharing Plans

The profit sharing plan is one of the most flexible qualified plans available. Employer contributions are usually made on a discretionary basis. Each year, the employer decides the amount, if any, to contribute to the plan.

The employer contribution is typically allocated to eligible employees proportionately to compensation. It may also be integrated with Social Security, which will result in higher contributions for higher paid participants.

Profit sharing plans may also use an age-weighted allocation formula, which would take into account both a participant's compensation and age. This allocation would result in higher contributions for older employees who are closer to retirement.

A profit sharing plan may also use a "cross-tested" allocation. This type of allocation is designed to maximize contributions for a certain group or groups of employees, such as owners, officers, etc.

401(k) Plans

Employee perception has made these the most popular retirement plans today. Employees can benefit from a 401(k) plan even if the employer does not make a contribution. This is due to the fact that employees can voluntarily elect to make pre-tax contributions through the ease of payroll deduction. In some cases, employees are also allowed to make after-tax payroll deductions to the plan.

In many instances, to encourage greater employee participation, the employer will match a portion of the amount contributed by the employee. This can be done on a discretionary basis, or with a fixed formula, such as a 25% match on the first 6% contributed by the employee. Since a 401(k) plan is a type of profit sharing plan, a profit sharing contribution may be made instead of or in addition to a matching contribution.

Both employee and employer matching contributions are subject to special non-discrimination testing.

These special non-discrimination tests can be eliminated if the 401(k) plan is designed as a **401(k) Safe Harbor Plan**. The plan would then be subject to minimum employer contribution and vesting requirements.

Defined Benefit Plans

Unlike a defined contribution plan, a defined benefit plan promises the employee a specific monthly benefit payable at a retirement age specified in the plan. Defined benefit plans are typically funded entirely by the employer, and the employer is responsible for contributing sufficient funds to the plan to pay for the promised benefits, regardless of investment earnings and employer profits.

The plan has a specific formula for determining the monthly retirement benefit. These benefits are typically based upon the employee's compensation and years of service with the employer.

An actuary determines the annual mandatory employer contribution, based on current employee data, and assumptions regarding projected future retirement benefits, turnover, life expectancy and investment performance.

Cash Balance Plans

A cash balance plan is a type of defined benefit plan that resembles a defined contribution plan.

As with the traditional defined benefit plan, a benefit is determined based on a fixed formula that takes into account the employee's compensation and years of service. Under the cash balance plan, the employee's benefit is then expressed as a hypothetical account balance instead of a monthly benefit.

Each employee's "account" receives an annual contribution credit, based on compensation, and an interest credit, specified in the plan, based on a guaranteed rate or recognized index. At retirement, the employee's benefit is equal to the hypothetical account balance, based on the sum of all contributions and interest credits. Typically, the employee would be allowed to take the cash balance and roll it over into an Individual retirement account, unlike the typical defined benefit plan which does not offer a lump sum payment at retirement.

As in a traditional defined benefit plan, the employer is responsible for contributing sufficient funds to the plan. An actuary determines the annual contribution to be made to the plan.