Qualified Retirement Plans – A Tax Deduction for Your Agency

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IT'S FALL, and that means time for tax planning. It is not too late to start a "qualified retirement plan" and receive a substantial deduction on your agency's tax return while saving for your own retirement.

Qualified Retirement Plans

These are plans in which the agency gets a tax deduction when the contribution is made. The money in the retirement plan accumulates tax deferred, until the money is actually removed.

There are several types of qualified plans. Each type of plan has a balance between ease of operation and contribution limits:

A Simplified Employee Plan or SEP-IRA is the easiest to adopt and operate. There is no government reporting once the plan is adopted. Every employee of the agency is eligible if he or she worked for the agency in 3 of the last 5 years, earned at least $450 in each year and is at least age 21. The maximum contribution is 25% of salary or $41,000, whichever is less. The minimum contribution is zero. The contribution amount can change from year to year but must be a level percent of pay for all eligible employees. Contributions are put into individual SEP-IRA accounts for each employee. Once in the account they are governed by IRA rules.

Another plan that does not require government reporting is the *Simple IRA.* Under this plan eligible employees, who earned at least $5,000 in the prior year, may elect to withhold contributions from their salary, up to a maximum of $9,000. This must be matched, dollar for dollar, up to 3% of the employee's pay. Or, the agency may contribute 2% of pay for every eligible employee whether or not he or she elects to contribute to the plan from salary. There can't be any deviation from the formulas or any profit sharing in addition. Contributions are put into individual SIMPLE-IRA accounts for each employee and are governed by IRA rules.

Next up the plan hierarchy is the *Profit Sharing Plan*. This plan has a lot more flexibility with contributions and much more ability to leverage higher contributions to the agency owner. It also allows a vesting schedule so that some of the contributions made on behalf of an employee are forfeited if the employee doesn't stay with the agency. The maximum contribution is $41,000, but it is often possible to get this to this amount while contributing 5% of pay for eligible employees. The contribution is flexible and discretionary from year to year. This type of plan does require annual government reporting. All the contributions are made by the agency.

A 401k plan is a type of profit sharing plan. The 401(k) plan allows employees to contribute towards their retirement, as well as the agency. One plan can cover 401(k) contributions, agency match and agency profit sharing. The money in the plan is usually put in individual accounts.

All the preceding plans are called *Defined Contribution* plans. These plans apply a specific contribution to a participant and the participant is credited with any gain or loss.

The *Defined Benefit* plan is much more technically sophisticated. It allows for much larger deductible plan contributions, but the agency gives up flexibility and discretion in terms of the contribution amount. Think of the Defined Benefit plan as the traditional pension plan. A fixed monthly benefit is earned at retirement, most likely a percent of pay. The benefit is paid monthly for life or a lump sum cash payment.

A variation of the Defined Benefit plan is the *412i, or fully insured Defined Benefit* plan. This is for the agency owner who needs insurance for planning purposes and is conservative. This type of plan allows even greater contributions, and as such, it is necessary to be financially able to fund this type of plan at high levels for five to seven years.

All the calculations must be done by an Enrolled Actuary, in compliance with ever changing IRS and DOL regulations. Deductible contributions can be much greater than in Defined Contribution plans, which are currently limited to $41,000. For older agency owners, the contributions can be greater than their compensation!

In summary, the world of retirement plans is a hierarchy – as you move up, deductible contributions increase, leverage increases (how much the owner keeps of the total contribution), but in return discretion is lost and administrative expense increases. MK

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