Retirement Benefits Designs, LLC

Our Look at Retirement Benefits 2014

12 Reasons to Establish a 401(k) Profit Sharing Plan?

By Kalinka Doneva, QPA, QKA

The current economic situation makes many people rightfully uncertain if their retirement benefits will provide the supplemental income they will need after retirement. History shows that generally people who continuously contributed to their employers' 401(k) plans were able to faster recover after each stock market crisis due to cost-averaging of the contribution deposits and the less risky investment options most 401(k) plans offer. In addition, many companies provide for employer contributions, such as match or profit sharing, which supplement for any temporary investment losses.

Retirement benefit plans, such as 401(k), profit sharing, defined benefit, 403(b), SEPs, Simple IRAs, etc., still offer the largest tax incentives from the Government. For the employees: pre-tax or after-tax contributions with tax-deferred earnings; for business owners: tax deduction on the employer contributions and tax credit for plan expenses. If properly designed and monitored, the tax advantages and savings of these plans could be truly great.

Here are 12 Reasons Why 401(k) Profit Sharing Plans Are Beneficial to Employees and Employers:

1. Tax Deduction for Employers: The employer contributions (profit sharing, match, etc.) are fully tax-deductible for up to 25% of gross compensation combined for all eligible employees. The annual contribution limit per person for 2014 (including 401(k) amounts) is $52,000, plus $5,500 catch-up 401(k) contribution for employees of age 50 or older.

2. Tax Credit for 3 Years for New Plans: Companies are eligible for up $500 tax credit per year for each of the first 3 years of a new qualified retirement plan to compensate for administrative fees (see IRS Form 8881). This applies for businesses with fewer than 100 employees.

3. Pre-Tax Salary Deferrals: 401(k) contributions deducted from the employees' paycheck are a very inexpensive benefit incentive. The employees save a portion of their gross pay pre-tax from each payroll and these amounts are invested in a trust account established for the plan. This salary deferral option is very flexible: payroll contributions could be changed or stopped frequently. The 401(k) contribution limit for 2014 is the lesser of $17,500 or 100% of gross compensation per person, plus a catch- contribution of up to $5,500, if the employee is of age 50 or older.

4. **After-tax Roth 401(k):** A post-tax employee contribution option known as Roth 401(k) could also be made available in a plan. The combined limit for both, pre-tax 401(k) and Roth 401(k) contributions is $17,500 plus a catch-up amount of $5,500 for 2014 (limited to 100% of gross compensation). These limits are subject to changes each year.

5. **Discretionary Employer Contributions:** Most employer contribution types (such as profit sharing or matching contributions) can be discretionary each year. In a low-profit year the business owners do not have to make any contributions, or could contribute less to the plan.

6. **Cost-Effective Customized Benefits:** 401(k) profit sharing plans can be customized to provide for different profit sharing contribution rates for each participant with higher employer contributions for the more valuable employees or those with longer service. These contributions can be on a vesting schedule based on years of service, which can also reduce the cost for the employers. The forfeitures from terminated participants' non-vested plan balances can be used to reduce future employer contributions or pay plan expenses. Most common vesting schedules are 6-years graded or 3-year cliff vesting. These customized features could greatly reduce the cost for the employers.

Distinctions between 401(k) Plans, SEPs and Simple IRAs:

- **SEPs (Simplified Employee Pension Plans)** do not allow for employee 401(k) contributions, only for employer profit sharing contributions. All employees must generally receive the same rate profit sharing contribution and must be fully vested immediately. The limit is $52,000 for 2014. Loans are not permitted from these plans.

- **Simple IRAs** have lower limits on the 401(k) contributions per person ($12,000 for 2014 and catch-up of $2,500 for age 50 or older) ,and allow for maximum of 3% employer contributions. There is no profit sharing option. Full vesting is required for all employees.

7. **Tax-Deferred Savings and Investments:** All contributions and investment earnings are not taxed until paid to the plan participant - normally after retirement. If an employee leaves the employer, he or she can roll over his plan assets to an IRA or another retirement plan and further defer paying taxes.

8. **Tax Credit for Employees:** Low-income employees can receive up to $2,000 tax credit by the Government when filing their tax returns, if they make elective deferrals to a 401(k), 403(b), Simple IRA or 457(b) plan. (IRS Form 8880).

9. **Investment Flexibility:** The plan could be generally set up to invest in a selected group of mutual funds, annuities or individual brokerage accounts. Plan participants most often have discretion over their investments but within carefully monitored investments. This reduces the investment risk for the employees, as well as the fiduciary liability of the plan sponsors/employers.

- **Fixed Annuities:** Some investment companies that provide recordkeeping for these plans offer guaranteed investments and fixed annuity payments (guaranteed income, guaranteed principal, etc.)

- **Life insurance** (term, universal or whole life) could also be purchased for individual participants. The premiums are paid through deductible employer contributions or employee salary deferrals.

10. **The Money is Not Locked Up:** 401(k) profit sharing plans could allow participants to take distributions from their accounts for hardship reasons to cover educational, medical, funeral and other expenses. They could also take a low-interest loan (most commonly at Prime rate plus 1%). Other in-service withdrawals after a certain period of participation or age 59.5 could be also permitted under the plan.

11. **Protection from Creditors:** The assets in all qualified retirement plans are protected from the Employer's general creditors. This includes plan assets of employees and business owners.

12. **Retirement Wealth:** Since the money in these plans is not as easily accessible as a bank account, they generally accumulate for a much longer period of time and could ensure retirement security.

For more information please feel free to contact us. We offer free plan reviews and customized design projections.

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Please feel free to contact us with any questions.

Kalinka Doneva, QPA, QKA

Managing Partner

Retirement Benefits Designs, LLC

445 Broadhollow Road, Suite 25

Melville, NY 11747

Tel. (631) 261-9500

Kalinka@BenefitsDesigns.com

WWW.BENEFITSDESIGNS.COM

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