BUSINESS LAW REPORT

Vol. 2, Issue 4

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EMPLOYER-SPONSORED, TAX QUALIFIED, RETIREMENT PLANS

By Jay D. Fullman, Esq.

Retirement plans come in many shapes and sizes. The U.S. Government offers a retirement plan: Social Security. Individuals may have a retirement plan: investments in real property, stocks, CDs, IRAs. Businesses offer retirement plans: 401(k), profit sharing, stock options, deferred compensation, defined benefit, split dollar life insurance, SIMPLE IRA, etc.

Employer-sponsored retirement plans fall into one of two categories: (1) "qualified plans" that provide tax-favored treatment of plan contributions, and (2) "non-qualified plans" that do not receive favored tax treatment. Non-qualified plans are often used by businesses to provide additional benefits to owners or highly compensated executives. However, to obtain favorable tax treatment, qualified plans must be offered to almost all employees.

Benefits of Qualified Plans

Some of the benefits of tax-qualified retirement plans are:

- They help attract and retain valued employees
- Employer contributions are tax deductible business expense
- Employer contributions are not taxable to employees
- Employees can also contribute, often with before-tax dollars
- Employees can direct their own investments
- Employees, not employers, usually bear the investment risk
- Plan investment earnings accumulate tax deferred

Types of Qualified Plans

SIMPLE. The Savings Incentive Match Plan for Employees can be established by employers with 100 or fewer employees. Employees can invest by making a salary reduction contribution (before tax dollars) of up to $6500 annually. Employers can also make tax-deductible contributions.

SEP. The Simplified Employee Pension allows employers to establish a retirement plan with little administrative expense. Employer and employee contributions (up to $25,500 annually) are placed in IRAs.

401(k). Retirement plans based on Internal Revenue Code Section 401(k) can allow employees to make contributions by salary reduction or by directing that bonuses be placed into the plan instead of received in cash. Employer contributions are (1) discretionary and, if made, (2) tax deductible, up to $10,500.

MONEY PURCHASE PENSION. The employer contributes a fixed percentage of each participating employee's compensation each year. Employer contributions are tax deductible and are not treated as taxable income to the employee.

PROFIT SHARING. As profits allow, employers make discretionary contributions to employee accounts. The contributions are tax deductible to employers and not taxable to employees. Contributions are limited to the lesser of $35,000 or 15% of the employee's compensation.

STOCK BONUS. This plan is similar to traditional profit sharing plans, but contributions are invested primarily in the employer's stock.

E.S.O.P. The Employee Stock Ownership Plan is essentially a stock bonus plan in which the employer's stock may be contributed to the retirement plan. ESOPs can also be used to facilitate the "buy-out" of major shareholders on a tax-deferred basis.

DEFINED BENEFIT. The employer contributes an actuarially determined amount to the plan to achieve the result of a defined (specified) retirement benefit. This type of plan generally favors older employees and can be used to quickly accumulate a specific retirement benefit through preferential tax treatment.

TAX SHELTERED ANNUITY. The TSA can be used by certain tax exempt 501(C)(3) organizations to provide tax-deferred retirement benefits for employees.

Other Options

There is much more to these identified plans than space allows. Additional qualified plans are also available. And, employers may instead prefer to implement non-qualified plans for certain employees. Please contact this office if you have any questions.