



**Harrisburg**  
2578 Interstate Dr, Ste 102  
Harrisburg, PA 17110  
(800) 805-2469

**Philadelphia**  
100 W Main St, Suite 208  
Lansdale, PA 19446  
(800) 805-2469

**Baltimore**  
23 Lincoln Woods Way  
Perry Hall, MD 21128  
(800) 805-2469

**Boston**  
2 Clock Tower Pl, Ste 290  
Maynard, MA 01754  
(800) 805-2469

## Retirement Plan Administrators, Consultants, Actuaries

### Qualified Plans

One of the best tax shelters available

*There is no better way to accumulate funds for retirement than through qualified plans. Their many tax and non-tax advantages make them an important part of any comprehensive employee benefit program.*

#### What is a qualified plan?

A qualified plan is a retirement plan that:

1. Enjoys favorable tax treatment by meeting special Internal Revenue Code and Department of Labor requirements and
2. Provides a way to accumulate substantial retirement income for both working owners and loyal employees.

#### How does a qualified plan provide tax advantages?

- The employer's contributions to the plan are tax deductible, subject to certain restrictions.
- The employee is not taxed on the contributions made for his benefit until distributions are made at some time in the future.
- Earnings from the plan's investments accumulate in a tax-exempt trust fund.
- Distributions in lump sum at retirement may qualify for favorable income tax treatment.
- Income taxes may be deferred by rolling over certain types of distributions to an IRA or to another qualified plan.

Qualified Plans

# Qualified Plans

## ***What are the non-tax advantages of a qualified plan?***

- Attract employees in a competitive labor market.
- Increase employee incentive.
- Reward long-term employees.
- Increase the business owner's wealth.

## ***How can a qualified plan increase a business owner's wealth?***

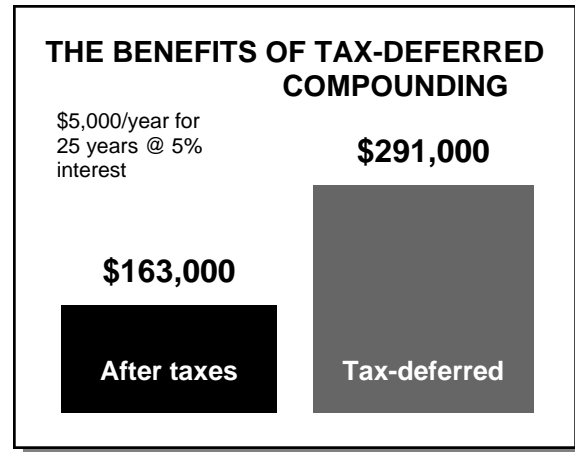
The business owner will accumulate more retirement dollars at a faster rate through the qualified plan. Contributions to the plan might be made in lieu of taxable (1) bonuses or dividends to a corporate owner, or (2) self-employment income for a sole proprietor or partner. The contributions are deductible, the owners avoid current income taxes, and the plan's investments build up tax-free with a greater total compounding of earnings than would otherwise be possible.

### ***Here's a simple example:***

Assume that Mary, the owner of a closely held corporation, is entitled to a \$5,000 bonus each year. She will keep about \$3,600 of the bonus after taxes (assuming a 28% marginal federal income bracket). If Mary invests that \$3,600 at 6% per year, she will earn about 4.32% net after taxes. After 25 years, she will have savings for retirement of about \$163,000 after taxes.

Assume that instead of paying Mary the bonus, the corporation contributes the \$5,000 to a profit sharing plan on her behalf. The full \$5,000 will be invested each year and will accumulate at the full 6% interest rate. Over 25 years, Mary's nest egg for retirement will be about \$291,000! Even assuming that tax rates in retirement aren't

lower (which they usually are), Mary's next egg, after taxes, would still exceed



\$163,000.

## ***Can taxes be deferred on plan distributions?***

Yes, many types of plan distributions can be rolled over to an IRA or to another qualified plan. Through rollover, the full distribution remains growing tax-deferred until the participant starts withdrawing the funds. At age 70 ½, a participant is required to begin taking at least a minimum distribution annually.

## ***Can a qualified plan be set up only for the business owner?***

Generally no. Although it may be possible to exclude a certain classification of employees, employees who otherwise meet the plan's minimum age and service requirements must be eligible to participate. In addition the plan must meet minimum coverage and participation requirements specified by the IRS.

## ***What are the minimum age and service requirements for participation?***

## Qualified Plans

A plan may exclude any employee who has not reached age 21 or completed at least two years of service. A service requirement exceeding one year requires immediate 100% vesting of a participant's benefits.

### **What does vesting mean?**

Vesting is the percentage of a participant's benefits which may not be forfeited if the participant terminates employment before a certain number of years. Plans which are "top heavy" can choose between two minimum vesting schedules: 6 year graded or 3 year cliff. Benefits in non-top heavy plans may vest less rapidly than top-heavy plans. The minimum vesting schedules are then: 7 year graded or 5 year cliff.

Years of Service	% Vested 6 year graded	% Vested 3 year cliff
Less than 1	0%	0%
1	0%	0%
2	20%	0%
3	40%	100%
4	60%	
5	80%	
6	100%	

**Here's how vesting works:**

### **What are top-heavy plans?**

Top heavy plans are plans in which the accumulated benefits for the key employees represents more than 60% of the total accumulated benefits for all plan participants. (Note: "key employee" is a technical term

defined in Internal Revenue Code regulations. If in doubt, contact us.)

### **Are there special requirements for top heavy plans?**

Yes. In addition to the special vesting shown above, minimum contributions and benefits are required for the non-key employees.

### **How does vesting reward working owners and long-term employees?**

In many types of plans, forfeitures (the benefits left behind by employees who are not 100% vested) are shared by the remaining plan participants. Adding forfeitures to a participant's account increases the funds set aside for retirement at no additional cost to the employer.

### **What are the major types of qualified plans?**

There are many types of qualified plans, each one appropriate to meet a different employer's needs. Following is a brief summary of the different plans and their distinguishing features.

**Profit sharing:** Contributions are usually discretionary providing the employer with maximum contribution flexibility. Because the employer can vary his contributions from year to year, these plans are often desirable if the employer is uncertain as to how much he will be able to contribute. The employer may contribute and deduct up to 15% of the compensation of the eligible plan participants, provided that no single participant's share exceeds the lesser of \$30,000 or 25% of his compensation.

**New comparability:** This plan is a new type of profit sharing plan which allows participants to be divided into classes with one targeted, highly compensated, and on aver-

## Qualified Plans

age, older group of employees receiving much higher contributions than the other classes. Because older individuals have fewer years to accumulate a retirement fund, they get a higher percentage of allocation than younger participants with more years to go to retirement age. In some cases, annual contributions can be as high as 25% of pay or \$30,000 each for the older, "highly compensated" group, with as little as 3% of pay to the accounts of younger, "non-highly compensated employees".

**401(k) plans:** These are profit sharing plans that allow before-tax employee contributions and may provide matching employer contributions. The maximum eligibility waiting period is one year of service, and the employee's contributions are limited to a maximum dollar amount each year (\$10,000 in 1998). The employee's funds enjoy tax-free growth in the plan and are taxable to the employee only when distributions are received.

**Employee stock ownership plans:** Employer contributions are made in the form of company stock or cash with which to buy company stock. Unlike other qualified plans, ESOPs are able to borrow money to purchase the company's stock and often provide a ready market for the owner's stock in a closely held corporation. An individual participant's share of the employer's contribution is limited to the lesser of \$30,000 or 25% of his compensation.

**Money purchase pension:** This plan obligates the employer to contribute a fixed amount each year, ordinarily a percentage of the participant's compensation. The employer can contribute and deduct 25% of the plan participant's eligible compensation, provided no individual participant's share of the contribution exceeds the lesser of \$30,000 or 25% of his compensation.

**Defined benefit:** This type of pension plan promises that participants will receive certain guaranteed benefits at normal retirement age. The employer's contribution is a fixed obligation and the limitation is placed on the promised retirement benefits, not the annual contribution necessary to fund the benefits. The contribution is actuarially calculated each year and takes into account such factors as participant's ages, compensation, forfeitures and the earnings on the plan's investments. An employer's contribution can sometimes greatly exceed the \$30,000 or 25% of pay limitation found in other types of qualified plans.

**Target benefit:** This plan is a cross between a money purchase plan and a defined benefit plan. The employer's contribution is a fixed obligation, and is subject to the same limits as a money purchase plan, however, the ages of plan participants are taken into account in determining the amount of the contribution. Unlike the promises of a defined benefit plan, participants' ultimate retirement benefits depend on the accumulation of contributions and earnings in their accounts at the time distributions are made.

**403(b) annuity:** Also known as a tax-sheltered annuity, this type of plan is available only to the employees of tax-exempt charitable organizations or public schools. Like 401(k) plans, these plans can allow before-tax contributions from employees as well as employer matching and discretionary contributions.

*We can show you how a qualified plan would work for your company or compare your existing plan to other plan alternatives. And, we can design the appropriate plan for you, install and administer it so that it runs smoothly and meets your objectives. We hope you'll call us.*