Retirement Plan Overview

A retirement plan can serve many purposes including attracting and retaining employees or tax sheltering income. It does not matter if you are a sole proprietor, partnership, or a corporation; there is a retirement plan design that will fit your needs.

A ***qualified retirement plan*** must meet a certain set of conditions set forth in the Internal Revenue Code (IRC). These include minimum coverage, minimum participation, vesting and funding requirements. If these conditions are met, the IRS provides tax advantages that include:

- Tax deductible contributions and plan expenses
- Tax-deferred earnings on investments
- Postponement of taxation to employee until distribution of benefit
- Protection of plan assets from creditors

Employers can choose between two types of qualified retirement plans or a combination of both: ***defined contribution*** and ***defined benefit plans***. Here is some general information about these types of retirement plans. We can help you choose the plan that is best for you.

Defined Contribution Plans

Under this type of plan, the contribution is defined that an employer makes to the plan. It is allocated among eligible employees. Individual account balances are maintained for each employee and grow through employer contributions, investment earnings and, in some cases, forfeitures (non-vested accounts of terminated participants). Some plans may also permit employees to make contributions on a pre-tax and/or after-tax basis.

The most common types of Defined Contribution Plans are 401(k) plans and profit sharing plans. Other types include 403(b) plans, Money Purchase plans and Employer Stock Ownership Plans (ESOPs).

- With a 401(k) plan, employees can benefit even if the employer does not make a contribution. Employees elect to make pre-tax or after-tax contributions through payroll deductions. The employer can match a portion of the amount deferred to encourage greater employee participation.
- The profit sharing plan is the most flexible qualified plan available. Employer contributions are made on a discretionary basis and allocated based on a specified formula.

Defined Benefit Plans

Instead of accumulating contributions and earnings in an individual account like a defined contribution plan, this type of plan promises the employee a specific monthly benefit payable at the retirement age specified in the plan. Typically, these plans are funded entirely by the employer. The plan has a specific formula for determining a fixed monthly retirement benefit based on compensation and years of service. Employer contributions to fund the promised benefits are mandatory.

A Cash Balance plan is a defined benefit plan that resembles a defined contribution plan in that the employee benefit is expressed as a hypothetical account balance instead of a monthly benefit. Each employee's "account" receives an annual contribution credit (usually a percentage of compensation) and an interest credit based on a guaranteed rate or some recognized index specified in the plan document. At retirement, the employee's benefit is equal to the hypothetical account balance plus the interest credits.