

Ask The Lawyer

by Marc S. Beckman

Marc S. Beckman is an associate with Scolaro, Shulman, Cohen, Fetter & Burstein, P.C. in Syracuse, NY, practicing in corporate and business groups with a special emphasis in representing health care professionals. You may contact Mr. Beckman at (315) 471-8111 or via e-mail at mbeckman@scolaro.com.

Time To Revisit Your **QUALIFIED RETIREMENT PLANS**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) has made it highly worthwhile to review your current qualified employee benefit plan structure to make sure you are maximizing your benefits while minimizing your costs.

Qualified retirement plans allow contributions to a participant's account to be deducted (subject to certain limits), but not currently taxable to the employee. Cash basis employers also have until their tax filing time to contribute the deductible contribution for the prior plan year. Both the employer and the employee may benefit from the tax-deferred accumulation under the plan. Finally, the employee/participant will benefit from favorable tax treatment upon distribution from the qualified plan.

There are two basic types of qualified plans: a defined contribution plan (DC) and a defined benefit plan (DB). A DC plan is an individual account where each employee's share of contributions, forfeitures and investment results is credited. Basically, it is the employer's contribution that is the "defined" portion of the plan. The employee's ultimate benefit is unknown, dependent on their share of earnings or losses of the plan's investments.

Employers using DB plans promise the participant a specified benefit amount subject to their remaining in the plan until the normal retirement age. Thus, the ultimate benefit is "defined" and the employer's contributions are unknown, dependent upon the earnings or losses of the plan's investments.

Whether you should adopt a DB plan or a DC plan depends on the ages and compensation histories of your employees, the level of contributions your company can afford, the profit history of your company, its risk aversion level, the length of the plan's expected existence, and the administrative costs for the plan(s) chosen.

The primary types of DC plans are profit sharing plans, money purchase pension plans, 401(k) plans and target benefit plans. A profit sharing plan is distinguished from other DC plans by its contribution flexibility. It allows the employer to decide whether to make a contribution on an annual basis and the level of the contribution. Prior to EGTRRA, the maximum contribution deductible was generally 15% of aggregate eligible plan year compensation. Employers were forced to combine profit sharing plans with other types of plans to increase the level of deductibility, increasing administrative costs.

Thanks to EGTRRA, the maximum deductible limit for profit-sharing plans is now 25% of aggregate participant compensation, the same permitted for money purchase plans. In addition, elective deferrals (i.e., 401(k) or Section 125 cafeteria plans) will not count against this 25% limit but rather toward the participant's aggregate compensation. This makes a profit sharing plan combined with a 401(k) a very attractive option.

Money purchase pension plans which, before EGTRRA, allowed an employer to provide larger contributions than a profit sharing plan, are now a much less attractive alternative. Money purchase plans must specify the level of contribution to be provided under the plan in accordance with a fixed formula, usually a percentage of each employee's compensation. Since profit sharing plans now have the same deductible limit as a money purchase plan but without the mandatory contribution, many employers will want to switch to a profit sharing plan.

A 401(k) plan is typically a profit sharing plan with a unique feature called a 401(k) deferral provision, allowing employees to elect to contribute a part of their compensation on a before-tax basis to the plan. Employers gain the advantage of having employees contribute to their own retirement while allowing employees to reduce their taxable income.

401(k) plans do not permit the same level of contributions as profit sharing or money purchase plans (up to \$11,000 for 2002 vs. \$40,000). But a 401(k) reduces the employer's plan cost while getting employees active in the cost of their own retirement.

A target benefit plan is a DC plan with characteristics of both a DB and a money purchase pension plan. Like a DB plan, the employer establishes a targeted ultimate benefit for each participant based upon their years of service and compensation. Like a money purchase pension plan, the benefit the employee actually receives is the amount in their account as of a certain triggering event, like termination or retirement. The contribution amount takes into account certain assumptions, the most important being the expected return on investments. It is important to note that no contribution flexibility is available to the employer and, once determined, the contribution must be made.

Finally, a cash balance plan is a DB plan with features of a DC plan, with individual "accounts" established for each participant, increased by hypothetical employer allocation and earnings. But the plan is funded like a DB plan. The annual contributions are determined actuarially and may be greater or less than the amount of actual earnings. The "account" consists of the contribution credits (normally a percentage of compensation) and an interest credit. The interest credit must be made without regard to what the plan actually owns on its investments. Thus, the risk of investment loss remains with the employer like a traditional DB plan.

Choosing which plan to utilize is a complicated decision based upon many legal factors and practical needs. Given the recent changes in the law with respect to qualified plans, employers are encouraged to talk to an employee benefits specialist about future planning. □

These materials have been prepared for educational and informational purposes only and are not intended as legal advice or legal opinions on any matter. Always consult an attorney before taking any action with respect to the subject matter addressed.