

Understanding the differences among retirement plan alternatives

2015 retirement plan summary



If you're establishing a new retirement plan, selecting the appropriate design is the first step in providing this important benefit. If you're reviewing your business's existing plan, you'll need to determine whether your company's and participants' needs have changed since you implemented the plan.

For most closely-held business owners, a Simplified Employee Pension IRA (SEP IRA) was once the most cost-effective choice. Then the Savings Incentive Match Plan for Employees IRA (SIMPLE IRA) became a viable alternative. Today, you may find that a defined benefit, profit sharing, or 401(k) plan best suits your needs. To make an informed decision on which plan is right for your business, review the differences.

Together we'll go far



SEP IRA

This plan is simple, flexible, and has low administrative costs.

Consider a SEP IRA plan if your business:

- Has volatile profits and low employee turnover
- Wants to provide a low-cost plan that's easy to administer
- Wants to provide a benefit only for long-term employees
- Employs few or no part-time individuals

When choosing this plan, keep in mind:

- You must be willing to contribute to part-time employees' accounts.
- This plan doesn't allow employees to save through payroll deductions.
- Contributions are immediately 100% vested.
- Withdrawals are subject to ordinary income tax and may be subject to a federal 10% penalty if taken prior to age 59½.

Employee eligibility and exclusions

You may exclude employees who:¹

- Are younger than age 21
- Were not employed by the business during any part of three of the previous five years
- Are covered under a collective bargaining agreement
- Are nonresident aliens receiving no U.S.-earned income
- Receive less than \$600 (for 2015, as indexed) in total annual compensation from the business in the year of contribution

Deadline for establishing the plan

A business's tax-filing deadline, including extensions, is the deadline for establishing the plan.

How the plan works

As an employer, you can contribute up to 25% of eligible employees' allowable compensation; however, the contribution for any individual cannot exceed \$53,000 in 2015.² Employer contributions are typically discretionary and may vary from year to year. The same formula must be used to calculate the contribution amount for all eligible employees, including any owner-employees.

To participate, each eligible employee must open an IRA. The business deposits contributions, which are not included in employees' taxable incomes, into these IRAs.

Here's an example

Eligible employees	Salary	25% contribution
Sam (owner)	\$100,000	\$25,000
Beth	\$50,000	\$12,500
John	\$20,000	\$5,000
Holly (part-time)	\$7,500	\$1,875
Cost for employer contributions*		\$19,375
Benefit to employer		\$25,000
Percent of benefit to owner		56.3%

*Excluding contributions for the owner.

Although business-owner Sam received the largest contribution from the plan, he was required to give the same 25% contribution to all of his employees. Note that even Holly, a part-time employee, received an equal contribution. This hypothetical example is based on an incorporated business and assumes the contribution is calculated on the basis of proportionate compensation for each eligible employee. The actual method for calculating contributions is based on the business structure and plan document.

1. Employer can implement less-restrictive requirements.

2. The maximum compensation that can be used to calculate individual contributions is capped at \$265,000 for 2015.

Profit sharing plan

These plans allow employees to share in the firm's profitability.

A profit sharing plan may be right for your company if you want to motivate your employees and give them a way to identify with, and participate in, the firm's profitability.

Profit sharing plans are best suited for companies:

- With more volatile profits
- Where employee turnover is moderate to high
- Where you want to exclude part-time employees
- Seeking flexible contribution methods

When choosing this plan type, keep in mind:

- The maximum amount you can contribute is 25% of the eligible employees' allowable compensation.³
- Individual allocations for each employee cannot exceed the lesser of 100% of compensation or \$53,000 in 2015.
- Appropriate IRS Form 5500, 5500-SF, or 5500-EZ, and applicable schedules, must be filed annually.⁴
- Age-weighted and new comparability plans have specific rules and require discrimination testing.
- A fidelity/surety bond may be required for 10% of the fair market value of plan assets, with a maximum of \$500,000.⁵
- Withdrawals are subject to ordinary income tax and may be subject to a federal 10% penalty if taken prior to age 59½.

Employee eligibility and exclusions

You may exclude employees who:⁶

- Are younger than age 21
- Have completed less than two years of service⁷
- Work less than 1,000 hours per year if using at least a one-year eligibility requirement
- Are covered by a collective bargaining agreement
- Are nonresident aliens receiving no U.S. earned income

Deadline for establishing the plan

The last day of the plan year is the deadline.

How the plan works

- **Profit sharing.** You contribute a portion of company profits into the plan, although contributions are not dependent upon profits. The amount contributed is allocated into accounts for individual employees.
- **Age-weighted and new comparability.** Allocation of employer profit sharing contributions is skewed to favor older employees. This is a more advanced plan design that requires additional annual administration and testing.

Here's an example

Eligible employees	Age	Salary	Traditional profit sharing	New comparability profit sharing	Age-weighted profit sharing
Sam (owner)	55	\$100,000	\$25,000	\$25,000	\$33,500
% of contribution			58.8%	87.7%	86.3%
% of salary			25%	25%	33.5%
Beth	35	\$50,000	\$12,500	\$2,500	\$3,943
% of contribution			29.4%	8.8%	10.2%
% of salary			25%	5%	7.8%
John	33	\$20,000	\$5,000	\$1,000	\$1,364
% of contribution			11.8%	3.5%	3.5%
% of salary			25%	5%	6.8%
Holly (part-time)	28	\$7,500	\$0	\$0	\$0
% of contribution			0%	0%	0%
% of salary			0%	0%	0%
Eligible total		\$177,500	\$42,500	\$28,500	\$38,807

Sam receives the bulk of the contributions in these plans; however, he needs to consider the extra administration fees for the new comparability and age-weighted features. Contribution amounts will vary year to year and are dependent upon the employees' mix of ages and salaries. This hypothetical example is based on an incorporated business using a one-year eligibility requirement.

3. The maximum compensation that can be used to calculate individual contributions is capped at \$265,000 for 2015.

4. May not be required for businesses that employ only owners and their spouses and have total plan assets of less than \$250,000, depending on the business structure.

5. The maximum bond limit is increased to \$1 million for retirement plans that hold employer securities.

6. Employer can implement less-restrictive requirements.

7. The plan may require at least two years of service before an employee is eligible to receive employer contributions, assuming the contributions are 100% vested. Eligibility requirements must be specified in the plan's adoption agreement.

Defined benefit and cash balance plans

These plans help you build savings quickly.

Consider a defined benefit or a cash balance plan if:

- The company seeks to offer permanent and ongoing retirement savings programs rather than temporary incentive devices
- The owner is age 40 or older and hasn't saved enough to achieve his or her financial goals for retirement

When choosing a defined benefit or cash balance plan, keep in mind:

- The plan generally produces a much larger tax-deductible contribution for the business than a defined contribution plan.
- You may impose a vesting schedule if using a one-year or shorter eligibility requirement.
- Annual employer contributions are mandatory and unpredictable.
- Employees aren't allowed to save through payroll deductions.
- The plan is more complex to administer than a defined contribution plan.
- The services of an enrolled actuary are required.
- Appropriate IRS Form 5500, 5500-SF, or 5500-EZ, and applicable schedules, are required.
- All plan assets must be held in a pool, and employees cannot direct their investments.
- A fidelity/surety bond may be required for 10% of the fair market value of plan assets, with a maximum of \$500,000.⁸
- Withdrawals are subject to ordinary income tax and may be subject to a federal 10% penalty if taken prior to age 59½.

Employee eligibility and exclusions

You may exclude employees who:⁹

- Are younger than age 21
- Have completed less than two years of service (immediate vesting will be required if two years selected)
- Work less than 1,000 hours per year
- Are covered by a collective bargaining agreement
- Are nonresident aliens receiving no U.S. earned income

Deadline for establishing the plan

The last day of the plan year is the deadline.

How the defined benefit plan works

A company with a defined benefit plan promises each participant a monthly benefit at retirement age. Employer contributions are actuarially calculated and mandatory each year.

Factors affecting an employer's contribution for a participating employee include the current value of plan assets and the employee's age, date of hire, and compensation.

A participating employee with a large projected benefit and only a few years until normal retirement age generates a large contribution because there is little time to accumulate the necessary value. The maximum annual benefit at retirement is the lesser of 100% of the employee's compensation or \$210,000 per year for 2015 (indexed for inflation).

You invest in a pool of money to provide benefits for all participating employees. Investment results do not affect employees' retirement benefits; rather, they cause the employer's cost to fluctuate.

Here's an example of a defined benefit plan for an incorporated business*

The normal retirement age is 62.

Employee	Age	W-2 Compensation	Defined benefit contribution†
Sam (owner)	55	\$265,000	\$160,000
Beth	35	\$30,000	\$10,000
John	50	\$30,000	\$30,000

As you can see, the closer a participant is to retirement, the higher the contribution. When a traditional defined benefit plan is too "expensive," a cash balance plan may be the answer for the employer.

* Prepared by July Business Services, Waco, TX.

† Contributions are not allocated to each participant but represent the annual cost of providing the monthly benefit.

How the cash balance plan works

A cash balance plan is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance.

Like a defined benefit plan, benefits under a cash balance plan must be definitely determinable; that is, the participant's benefit at retirement age must be determined by the plan. This is accomplished by defining the contribution (pay) credits and interest credits in the plan documents. In a cash balance plan, the participant's "account" is credited with:

- Pay credit (for example, 5% of compensation from the employer)
- Interest credit (may be either a fixed amount or a variable rate tied to a benchmark, such as the rate paid by Treasury bills)

These accounts are often referred to as "hypothetical accounts" because they do not reflect actual contributions to an account or actual gains and losses allocable to the account.

8. The maximum bond limit is increased to \$1 million for retirement plans that hold employer securities.

9. Employer can implement less-restrictive requirements.

SIMPLE IRA

This plan is for owners who want minimal fiduciary exposure.

If you want a plan that encourages employees to save for retirement, a SIMPLE IRA might be appropriate for you.

Key considerations include:

- You must have 100 or fewer eligible employees who earned \$5,000 or more in compensation in the preceding year (defined by Form W-2 issued for the calendar year).
- The company must not maintain any other employer-sponsored retirement plan to which contributions are made or accrued during the calendar year in which the SIMPLE IRA plan is effective.

When choosing this plan, keep in mind:

- This plan is simple and flexible and has low administrative costs.
- There are no annual IRS filings or complex paperwork.
- Your contributions are tax-deductible for the business.
- The plan encourages employees to save for retirement through payroll deductions.
- Annual employer contributions are mandatory and limited.
- Annual notification of eligibility and employer contributions is required.
- This plan has lower employee deferral contribution limits than 401(k) plans [see 401(k) limits on page 6].
- You cannot exclude part-time employees.
- Contributions are immediately 100% vested.
- Withdrawals are subject to ordinary income tax and may be subject to a federal 10% penalty if taken prior to age 59½. The federal penalty increases to 25% if taken during the first two years of plan participation.

Employee eligibility and exclusions

You may exclude employees who:¹⁰

- Have not received more than \$5,000 in salary from the business during each of any two preceding years (not necessarily consecutive)
- Are reasonably expected to receive less than \$5,000 in the current year
- Are covered by a collective bargaining agreement
- Are nonresident aliens with no U.S. earned income

10. Employer can implement less-restrictive requirements.

11. Transfers and rollovers from other SIMPLE IRAs can be deposited into the account. Traditional, SEP, and/or Roth IRA contributions cannot be made into a SIMPLE IRA. Qualified plan assets cannot be rolled over or transferred into a SIMPLE IRA.

12. Only individuals aged 50 and older can make catch-up contributions.

13. Subject to cost-of-living adjustments.

14. The lower matching percentage cannot occur more than two out of any five years.

Deadline for establishing the plan

The deadline is Oct. 1 for contributions in current calendar year (plan year must be calendar).

How the plan works

To participate, an eligible employee must open an IRA into which you deposit contributions. Both employee and employer contributions are excluded from the employee's taxable income.

Employee contributions. The employee may elect to make salary-reduction contributions. Both you and the employee must understand that only SIMPLE IRA contributions can be deposited into the SIMPLE IRA.¹¹ Employee contribution limits for 2015 are as follows: The salary deferral is \$ 12,500¹³, and the catch-up contribution¹² is \$3,000.¹³

Employer contributions. One of these formulas must be used to calculate your tax-deductible contribution:

- A dollar-for-dollar matching contribution up to 3% of an employee's compensation or a lower matching contribution (not less than 1%).¹⁴ Matching contributions are limited to the employee contribution limit per above (adjusted periodically for inflation).
- A nonmatching contribution of 2% of compensation for each eligible employee (based on a maximum \$265,000¹³ in compensation).

Here's an example

This hypothetical example compares a 3% matching contribution with the 2% nonelective contribution.

3% matching contribution					Cost for employer contributions*
	Sam (owner)	Beth	John	Holly (part-time)	
Salary	\$100,000	\$50,000	\$20,000	\$7,500	
Deferral	\$12,500	\$4,000	\$0	\$6,000	
Employer match	\$3,000	\$1,500	\$0	\$225	\$1,725
Total	\$15,500	\$5,500	\$0	\$6,225	
2% nonelective contribution					Cost for employer contributions*
	Sam (owner)	Beth	John	Holly (part-time)	
Deferral	\$12,500	\$4,000	\$0	\$6,000	
Employer contribution	\$2,000	\$1,000	\$400	\$150	\$1,550
Total	\$14,500	\$5,000	\$400	\$6,150	

*Excluding contributions for the owner.

Notice that with a 2% nonelective contribution, Sam is required to give John a contribution even though he did not participate in salary deferral; however, the 2% contribution to all employees is still less than the overall contribution to the employees with the 3% matching contribution. This example is based on an incorporated business where all employees are younger than age 50.

401(k) plans

A number of variations may make 401(k) plans a good option for your business.

- The plan encourages employees to save for retirement.
- Employer contributions are tax-deductible for the business.
- Contributions have the potential to grow tax-deferred.

Traditional and safe harbor 401(k)

These plans are for employers who want to share in the responsibility of providing employees' retirement savings and encourage employee savings.

When choosing 401(k) plans, keep in mind:

- Appropriate IRS Form 5500, 5500-SF, or 5500-EZ, and applicable schedules, must be filed annually.
- Discrimination testing applies to traditional 401(k) plans.
- A fidelity/surety bond may be required for 10% of the fair market value of plan assets, with a maximum of \$500,000.¹⁵
- Employer contributions and individual allocation limits are the same as for profit sharing plans.
- Safe harbor 401(k) plans without automatic enrollment require that employer contributions be immediately 100% vested.
- Safe harbor 401(k) plans with automatic enrollment, also referred to as a qualified automatic contribution arrangement (QACA), require that employer contributions be 100% vested after two years.
- Withdrawals are subject to ordinary income tax and may be subject to a federal 10% penalty if taken prior to age 59½.

Employee eligibility and exclusions

Employer may exclude employees who:¹⁶

- Are younger than age 21
- Have completed less than two years of service¹⁷
- Work less than 1,000 hours per year (if using at least a one-year eligibility requirement)
- Are covered by a collective bargaining agreement
- Are nonresident aliens receiving no U.S. earned income

Deadline for establishing the plans

The deadline for a traditional 401(k) plan is the last day of the plan year but no later than the commencement of employee contributions.

The deadline for safe harbor 401(k) plans is at least three months prior to the end of the initial plan year.

How the plans work

Employee salary deferrals and your contributions are deposited into accounts.

- **Traditional 401(k).** This plan requires annual non-discrimination testing (commonly referred to as the ADP/ACP tests) to ensure that employee deferrals and employer matching contributions do not discriminate in favor of business owners and other highly compensated employees.
- **Safe harbor 401(k).** The safe harbor rules eliminate discrimination testing and let highly compensated employees maximize their salary deferral contributions regardless of the participation levels of non-highly compensated employees. To satisfy these rules, a plan must meet both contribution and notification requirements, and you must make fully vested contributions.

Employee contribution limits for 2015 are as follows: salary deferral, \$18,000;¹⁸ catch-up contribution,¹⁹ \$6,000.¹⁸

Employer contributions

- **Traditional 401(k).** Your contributions are discretionary and can be structured as matching, nonmatching, and/or a combination of the two.
- **Safe harbor 401(k).** Your contributions are required and can be structured as matching²⁰ or nonmatching.²¹ You have the flexibility to make additional discretionary contributions within the plan limits and still avoid discrimination testing. These contributions may be subject to vesting.

15. The maximum bond limit is increased to \$1 million for retirement plans that hold employer securities.

16. Employer can implement less-restrictive requirements.

17. A 401(k) plan may require only up to one year of service before letting employees make salary-deferral contributions. The plan may require at least two years of service before an employee is eligible to receive employer contributions, assuming the contributions are 100% vested. Safe harbor 401(k) plans are limited to requiring one year of service for employee and employer contributions. Eligibility requirements must be specified in the plan's adoption agreement.

18. Subject to cost-of-living adjustments.

19. Only individuals aged 50 and older can make catch-up contributions.

20. Basic match: dollar-for-dollar on first 3% of compensation; 50 cents on the dollar for next 2% of compensation.

21. A nonmatching safe harbor contribution is 3% of each eligible employee's compensation.

Safe harbor 401(k) with automatic enrollment (QACA)

The QACA follows many of the same provisions as a safe harbor 401(k) plan without the automatic enrollment feature. The differences between these two types of plans are in three key areas:

Employer contribution requirements

Plan sponsors may elect either:

- Dollar-for-dollar matching contributions on the first 1% of deferral plus 50 cents on the dollar for the next 5% deferred. Example: Employee Beth elects to defer 6% of her salary into the plan. The employer matching contribution would be 3.5% of Beth's compensation (see illustration below).
- Nonmatching contributions are equal to 3% of compensation to all eligible employees.

Employee contributions

Instead of requiring employees to make a positive election to participate in the 401(k) plan, the QACA assumes the employee will participate in the plan unless the employee positively elects not to participate.

- Entry-level deferral contributions must be at least 3% but no more than 10% of total compensation.
- Subsequent years require annual contribution increases: year two = 4%, year three = 5%, and year four and subsequent years = 6%.

Vesting schedule

Your contributions funded under the QACA can use a vesting schedule requiring two years of service before becoming 100% vested. [A traditional safe harbor 401(k) requires that your contributions be 100% vested immediately.]

Here are some examples

Eligible employees	Salary	Traditional 401(k)			Safe harbor 401(k)			
		Salary deferral	Sal. def. %	Employer cont.	Salary deferral	Sal. def. %	Employer basic match	QACA
Sam (owner)	\$100,000	\$6,500	6.5%	\$3,000	\$18,000	18%	\$4,000	or \$3,500
Beth	\$50,000	\$3,000	6%	\$1,500	\$3,000	6%	\$2,000	or \$1,750
John	\$20,000	\$600	3%	\$600	\$600	3%	\$600	or \$400
Holly (part-time)	\$7,500	\$0	0%	\$0	\$0	0%	\$0	or \$0
Total	\$177,500	\$10,100		\$5,100	\$21,600		\$6,600	or \$5,650
Percent of contribution to the owner			59%				61%	62%

With the traditional 401(k), Sam's deferrals are limited based on the participation of his employees. However, with the safe harbor 401(k), Sam can maximize his deferrals in exchange for providing

a safe harbor contribution for his employees. This hypothetical example is based on an incorporated business using a one-year eligibility rule with all employees under the age of 50. The employer contribution in the traditional 401(k) assumes a matching formula of 3% up to 100% of compensation.

Roth 401(k) feature

Businesses can add a Roth 401(k) feature to their 401(k) plans. If you opt to offer this feature, you and your employees can each contribute up to \$18,000 in 2015, plus a \$6,000 catch-up contribution for those aged 50 or older, in any combination of Roth 401(k) or traditional salary deferral 401(k) contributions.

The Roth 401(k) applies the same concept as the Roth IRA by allowing after-tax contributions with the potential of receiving tax-free distributions after age 59½, assuming at least five years have passed since the first Roth 401(k) contribution.

However, unlike Roth IRA contributions, Roth 401(k) contributions are considered salary deferrals. In addition, there are required withdrawals from Roth 401(k) plans starting at age 70½, similar to those incurred with a traditional 401(k) plan.

Owner-only 401(k)

This plan is for companies that employ only owners and their spouses. It lets you increase your retirement savings while keeping plan administration costs relatively low.

Is this plan for you?

Advantages of an owner-only 401(k) plan include:

- Plan contributions can be substantial.
- Contributions have the potential to grow tax-deferred.
- Salary deferrals decrease the owner's taxable income.

When choosing this plan, keep in mind:

- The company cannot employ anyone other than owners and their spouses.
- Withdrawals are subject to ordinary income tax and may be subject to a federal 10% penalty if taken prior to age 59½.

Employee eligibility and exclusions

Only owners and their spouses may participate.

Deadline for establishing the plan

The deadline is the last day of the plan year but no later than the commencement of employee contributions.

How this plan works

In 2015, you can make contributions of up to 25% of total eligible compensation in addition to your salary-deferral

contributions of \$18,000. The combination of employer and employee contributions cannot exceed the lesser of 100% of each individual's compensation or \$53,000. Owners aged 50 or older can make additional \$6,000 catch-up contributions for 2015, which could increase their total contribution to \$59,000.

Here's an example

The amount you or your spouse can contribute varies based on your compensation.

This hypothetical example is based on an incorporated business with an owner who is younger than age 50.

Salary	Salary deferral	Employer contribution	Total
\$30,000	\$18,000	\$7,500	\$25,500
\$50,000	\$18,000	\$12,500	\$30,500
\$100,000	\$18,000	\$25,000	\$43,000
\$150,000	\$18,000	\$32,500	\$50,500

Additional considerations for plan sponsors

Receiving a tax credit

You can take advantage of a nonrefundable tax credit the federal government offers to encourage companies with 100 or fewer employees to establish and maintain retirement plans. The credit applies to 50% of the first \$1,000 in administrative and retirement-education expenses (start-up expenses) for the first three years the plan is established.

Maintenance of defined benefit/cash balance plans and defined contribution plans

The Pension Protection Act of 2006 increased the deduction limit for multiple plans. As a result, the combined plan-deductible limits [IRC 404(a)(7)] for employers that maintain defined contribution and defined benefit plans apply only to the extent employer contributions to the defined contribution plan (excluding elective deferrals) exceed 6% of compensation.*

Certain defined contribution plans may not be funded in addition to the defined benefit and cash balance plans. These include:

* Assuming the defined benefit plan is not insured by PBGC.

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How we can help

Our approach to business retirement plans focuses on two key advantages — flexibility and personal service. We offer you a wide array of retirement plan alternatives and the freedom to select only those services that meet your needs. These services include:

Investments. We provide a range of investment choices, such as certificates of deposit, money market funds, individual stocks and bonds, collective funds, private money managers, and mutual funds.

Record keeping. We can work with your existing administrator, help locate a provider, or work with individual tax professionals who provide administration and prototype document services.

We can help determine which plan is right for you. Using information you provide, we will:

- Review your business's goals and objectives and/or existing retirement plans
- Run hypothetical illustrations

For more information about products and services we offer to support retirement plans, contact your Financial Advisor.

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