Qualified Retirement Plans

Qualified retirement plans are Congressionally-approved retirement plans which have several major tax benefits.

- The employer's contributions can be deducted for income tax purposes.
- The earnings on the plan's investments accumulate on a tax-deferred basis.
- When the funds are distributed at retirement age, they may be eligible for favorable tax treatment.[1]
- Taxpayers may be in a lower income tax bracket after retirement.

Two Principal Types of Plans

Qualified retirement plans can generally be classified as either defined benefit or defined contribution plans.[2]

Defined benefit plans: Specify the dollar amount each participant will receive at retirement age and then estimate how much must be contributed each year to accumulate the necessary future fund. Interest rates, ages of participants, etc., will have an effect on the calculation. The amount of the contribution is generally determined by an actuary. The investment risk rests on the employer.

Defined contribution plans: Generally put a percentage of current salaries into the plan each year. The amount at retirement will depend on the investment return and number of years until a participant retires. The investment risk rests on the participant.

Plan Type	Contributions	Retirement Benefits	Investment Risk
Defined benefit	Vary	Fixed	Employer
Defined contribution	Pension – Fixed Profit sharing – Vary	Vary	Employee

[1] Those born before 1936 may be able to elect 10-year averaging or capital gains treatment; these strategies are not available to those born after 1935.

[2] Note that some plans have features of both types.

Qualified Retirement Plans

What Is the Best Type of Plan?

There is no best type of plan. The choice of what type of plan to use is an individual one. The answer depends on factors such as employer goals and available cash flow.

Defined Benefit Plans

The employer contributes an actuarially-determined amount sufficient to pay each participant a fixed or defined dollar amount at his or her retirement. The benefit may be defined as a flat percentage of compensation, a percentage which increases with years of service, or a percentage which changes at certain compensation levels, etc.

This type of plan generally favors older employees, because more of the employer's contributions must go into his or her account to make certain that there will be enough to pay the promised (or defined) benefit at retirement age.

Defined Contribution Plans

There are several variations of defined contribution plans. Some of the more common ones include the following:

- **Money purchase pension:** The employer contributes a specified percentage of the participating employee's salary each year. Whatever that fund grows to is what the retiring employee receives.
- **Target benefit pension plan:** The target benefit plan has elements of both the defined benefit and defined contribution plans. The benefits are determined as if the plan were a defined benefit plan, while the defined contribution plan annual contribution percentage and dollar amount limitations apply to the actual contributions.
- **Traditional profit sharing plan:** Similar to the money purchase pension, except that contributions do not need to be a specific percentage and they do not need to be made every year, as long as they are substantial and recurring.
- **Age-weighted money purchase and profit sharing plans:** Money purchase and profit sharing plans in which employer contributions are allocated to provide an assumed equivalent retirement benefit at normal retirement age.

- **Cross-tested or super-integrated money purchase and profit sharing plans:** These plans establish groups of participants to which are allocated specified allocation percentages. They must satisfy very complicated discriminatory requirements under Reg. 1.401(a)(4).

- **Stock bonus plan:** Similar to the traditional profit sharing plan. The plan may, but is not required to, invest primarily in the employer's stock.

- **ESOP - Employee stock ownership plan:** Like a stock bonus plan, to which the employer can contribute company stock instead of cash. The plan must be primarily invested in company stock.

- **IRC Sec. 401(k) plan:** Also called a cash or deferred plan, this plan is any stock bonus plan or profit sharing plan which meets certain participation requirements of IRC Sec. 401(k). An employee can agree to a salary reduction or to defer a bonus which he or she has coming.

- **SIMPLE plans:** SIMPLE stands for Savings Incentive Match Plan for Employees. SIMPLE plans can be in either an IRA format or a 401(k) format.

- **SEP:** This stands for Simplified Employee Plan. A SEP is a group of individual IRAs established for employees to which the employer and employees may contribute more than an individual employee could contribute to a traditional IRA or Roth IRA.