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Choosing a Retirement Plan

Employers recognize that providing tax-favored retirement benefits makes good business sense.

Prospective employees consistently rank the presence of a retirement plan as an important factor in deciding whether to accept a job offer. A robust retirement plan offering also helps an organization retain its valued employees. As such, it can be a key component of any firm's employee benefits program.

A retirement plan gives employees and small business owners the opportunity to set aside funds for their future financial security — and that's critically important given that Americans are living longer and should not rely on Social Security as their sole source of retirement income. Typically, contributions to a retirement plan and the earnings on those contributions are not subject to income taxation until plan participants begin making withdrawals. This tax deferral advantage allows plan funds to grow without being depleted by annual taxes.

Just as important, there are tax advantages for the employer that sponsors a tax-favored retirement plan. Contributions are deductible, within certain limits. In addition, a tax credit is available to eligible small employers for a portion of the costs of starting the retirement plan. The credit equals 50% of the cost to set up and administer the plan and educate employees about the plan up to a maximum credit of $500 per year for each of the first three years of the plan.

Employers can select the type of retirement plan that meets their business needs and workforce demographics. Some plans mandate that employers must make annual contributions while others offer more flexibility. Some plans allow only employer contributions while others permit both employer and employee contributions. And some plans are more complex to administer than others. Of course, given the fact that retirement plans must meet various regulatory requirements, professional advice during the initial stages of the selection process is essential.

What follows is an overview of different types of tax-favored retirement plans that are popular with today's employers.

1 401(k) Salary Deferral Plan

Well-known and widely used, 401(k) plans give employees the opportunity to save for their retirement through automatic payroll deduction. Employees who choose to participate in the plan may elect to have a percentage of their pay deposited into a plan account on a pretax basis, potentially lowering their current income taxes. All contributions employees make and the potential earnings on those contributions will not be taxed until the employee begins making withdrawals, usually at retirement. Including a Roth contribution option in a 401(k) plan gives plan participants additional flexibility. Although Roth contributions are made after tax, withdrawals from a Roth 401(k) account are tax free, provided certain conditions are met.

Employees typically can choose from a menu of investment choices offered by their plan when deciding how and where to invest their plan contributions. As plan sponsor, the employer may choose to match a portion of employees' 401(k) contributions. It's also possible for the employer to make contributions for all eligible employees, whether or not they defer salary to the plan.

The tax law sets annual limits on employee salary deferrals, the amount of plan contributions that employers may deduct, and total additions to a participant's plan account, which the IRS periodically adjust for inflation (see schedule 1).

Employers enjoy these benefits from a 401(k) plan:
The business can currently deduct contributions of employee salary deferrals and employer contributions, if all the requirements of the tax law are met. Owner-employees can participate in the plan. A 401(k) plan can be more cost-effective and easier to maintain than a traditional pension plan. The plan may enhance productivity and assist in attracting skilled, desirable employees.

As with other tax-qualified plans, a Form 5500 (*Annual Return/Report of Employee Benefit Plan*) must be filed for a 401(k) plan. Certain nondiscrimination rules apply, and annual testing of salary deferrals and employer-matching contributions may be required to ensure that the plan does not unduly favor highly compensated employees. The plan must also distribute certain notices and disclosures to participants and beneficiaries in a timely manner.

Solo 401(k) Plan

An individual (also known as a solo or one-participant) 401(k) plan may be right for those who are self-employed or own a small business with no employees other than a spouse. Since the plan covers only the owner (and potentially his or her spouse), the issue of disparate benefits doesn't arise, so there is no need to perform the type of nondiscrimination testing typically required of 401(k) plans. However, an individual 401(k) plan generally has to file an annual report on Form 5500-SF if it has $250,000 or more in assets at the end of the year. Plans with fewer assets may be exempt from the filing requirement.

2 Cash Balance Plan

Cash balance retirement plans are considered "hybrid" retirement plans since they use a combination of features from both defined benefit and defined contribution plans. Like a traditional defined benefit plan, a cash balance plan provides a specific benefit at retirement for each eligible employee. However, a cash balance plan defines the promised benefit in terms of a stated account balance, much like a defined contribution plan.

For regulatory purposes, a cash balance plan is a defined benefit pension plan. That means that the plan's funding limits, funding requirements, and investment risk are based on defined benefit requirements, and the benefits promised by the plan are usually insured by the Pension Benefit Guaranty Corporation, a federal agency. The employer assumes the risk of any trust fund earnings shortfall or losses that are in excess of the actuarially determined amount required to fund the plan.

The employer is responsible for making all contributions to the plan. The plan's assets are commingled in the plan trust for investment purposes, but separate notional

(or "hypothetical") accounts are created for each covered employee. Typically, the employer credits the participant's account each year with a set percentage of his or her annual compensation (a pay credit) plus interest (an interest credit). In order to determine the participant's accrued benefit at any particular time, the hypothetical account balance is projected, with interest, to normal retirement age. This projected lump-sum amount is then converted to an annuity by dividing the amount by the annuity purchase rate specified under the plan.

Cash balance plans are usually set up to pay lump-sum benefits equal to the hypothetical account balance at any point in time. The benefit formula, or the Hypothetical Allocation Formula, must be stated in the plan.

Cash balance plans are particularly attractive to small employers and professional groups, such as physicians or lawyers. The contributions for cash balance plans are calculated based on the employees' ages, compensation, and employee classification. Because the plan provides generous benefits for the owner or key employee, it is typically set up in combination with a 401(k) plan so that together they can satisfy the tax law's nondiscrimination requirements.

A combination plan can provide participants with a larger amount of retirement savings than would be possible through a stand-alone 401(k) plan. However, the owners of the business derive the greatest benefit from a cash balance plan inasmuch as they can make significant contributions for themselves every year.

An annual Form 5500 filing is required.

3 Profit Sharing Plan

A profit sharing plan is a tax-qualified plan that allows employees to share in the profits of the business. It is a flexible alternative in that the employer can design the plan so that the amount of the contribution will be linked to the performance of the business each year. If profits are down one year, the business is not obligated to make a contribution. Moreover, the contribution amount can vary from year to year. All contributions the employer makes are deductible in the year they are made, within tax law limits.

Employees benefit from having a retirement program offered through their employer. And a big plus for employees is that:

- ☑ All employer contributions to a profit sharing plan are not taxed to employees while they participate in the plan.
- ☑ All earnings in employees' profit sharing plan accounts grow tax deferred.
- ☑ Employees pay taxes only when they begin receiving distributions from the plan. By then, they may be in a lower federal income tax bracket.

While profit sharing plans are subject to certain non-discrimination requirements, they are not subject to the funding requirements applied to pension plans. An annual Form 5500 filing is required.

Combined 401(k)/Profit Sharing Plan

It is also possible to establish a 401(k) profit sharing plan. Or, if an employer already has a 401(k) plan in place, the employer could add a profit sharing feature. A combined plan must include all eligible employees, including those who do not elect to defer salary. The addition of a profit sharing component to an existing 401(k) plan can be advantageous as it may allow for higher plan contributions than a 401(k) plan alone. It can also help a business meet nondiscrimination requirements by encouraging higher levels of participation in the plan.

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4 Simplified Employee Pension (SEP) Plan

Used primarily by small employers and the self-employed, a Simplified Employee Pension (SEP) plan must allow all eligible employees to participate. Eligible employees are those who are at least 21 years of age and who have been employed by the business for at least three of the last five years and earned at least $600 during the year (for 2019).

A SEP plan allows employers to contribute directly to traditional individual retirement accounts (IRAs) for their employees on a tax-deductible basis. Self-employed business owners may also contribute on their own behalf. The employer is not obligated to make contributions every year. However, when the employer contributes, the amount contributed for each participant generally must be the same percentage of compensation. A newly established SEP plan may not accept employee contributions.

Businesses that offer a SEP plan benefit in several ways:

- The employer contribution may vary from year to year, providing flexibility when cash flow is uncertain.
- SEP plans are relatively easy to set up and administer and generally have low administrative costs.
- An annual Form 5500 filing is generally not required.

5 Savings Incentive Match Plan for Employees (SIMPLE) IRA Plan

Any small business with 100 or fewer employees that does not currently have another retirement plan can set up a SIMPLE IRA. The plan must be offered to all employees who have earned at least $5,000 in two previous years and are reasonably expected to earn $5,000 in the current year.

Unlike the SEP plan, a SIMPLE IRA allows *employee and employer* contributions. Employer contributions are mandatory. The size of the employer contribution is determined by a specific formula (see schedule 1).

As is the case with a SEP plan, employees are fully responsible for their investment selections in a SIMPLE IRA. An annual Form 5500 is not required, although certain documents must be distributed to inform employees about the plan.

6 Defined Benefit Pension Plan

A defined benefit pension plan provides each eligible employee with a fixed retirement benefit that is determined by a formula chosen by the employer and written into the plan document. The choice of the benefit formula is flexible: Employers can choose to base the benefit on a percentage of pay, on an amount per year worked, or on several other methods.

The employer is required to contribute enough each year to fund the promised benefit. That funding must be maintained even during those times when the employer does not make a profit. In addition, the employer shoulders the investment risk of the plan. If the plan's investments underperform, the employer may be required to make a larger contribution to ensure the promised benefits are funded properly.

Despite these restrictions, defined benefit pension plans are popular among certain employers and employees.

EMPLOYERS can potentially	**EMPLOYEES** can take advantage of
Claim a current tax deduction for contributions to the plan	Greater retirement benefits built up over shorter periods

Employers like them because they may claim a current tax deduction for contributions to the plan, within the tax law's limits. Employees like them because pension plans allow greater retirement benefits to be built up over shorter periods than is the case with defined contribution plans. This is particularly helpful to older owner employees.

Plan contributions and earnings are not currently taxed to the employees. However, employees are taxed when they receive plan benefits.

7 Individual Retirement Accounts (IRAs)

There are two types of IRAs – the traditional IRA and the Roth IRA. They each offer individuals an opportunity to set money aside for retirement. They are a flexible option for saving in that the owner of the IRA account can decide how much he or she can afford to contribute up to the IRS ceiling in effect for the year. The maximum annual contribution amounts are adjusted for inflation yearly. Both types of IRAs are different in several significant ways.

TRADITIONAL IRA	ROTH IRA
Contributions are tax deductible if certain IRS requirements are met	Contributions are not tax deductible
Account earnings are tax deferred	Account earnings are tax deferred
Withdrawals are taxable as ordinary income	Withdrawals are tax free if certain IRS requirements are met

- Contributions to a traditional IRA are fully tax deductible when the individual is not eligible to participate in an employer sponsored retirement plan. With plan participation, an individual's ability to make a tax deductible contribution depends on income. As income increases above certain limits, the deduction is reduced and eventually eliminated.

- Similar to tax deductible contributions to a traditional IRA, contributions to a Roth IRA are phased out above certain income levels.

Call (844) PROCYON today

Do you need alternative options for your retirement plan? Contact Christopher E. Foster at Procyon Partners for more information on cash balance retirement plans and whether they are right for your organization.

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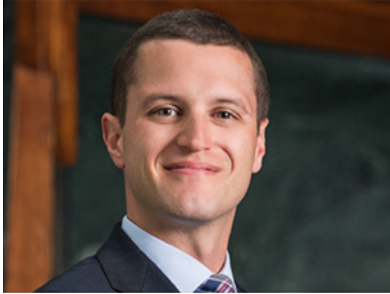
Schedule 1: Retirement Plans at a Glance

PLAN TYPE	401(K)	CASH BALANCE	PROFIT SHARING	SEP	SIMPLE IRA	PENSION PLAN	TRADITIONAL IRA AND ROTH IRA
Potential Users	• Any size business/ self-employed	• Small employers/ professional groups	• Any size business	• Small employers/ self-employed	• Small employers with 100 or fewer employees and no other active retirement plan	• Any size business/ professionals	• Employed/ self-employed • Traditional IRA: Individuals not covered by an employer-sponsored retirement plan
Plan Benefits	• Higher contribution limits than SIMPLE IRA • Optional loan provisions • Flexible vesting • Employees may contribute pretax • Optional Roth feature	• Generous contribution limits • Flexible vesting	• Discretionary contributions • May have other retirement plans • Optional loan provisions • Flexible vesting	• Employer has flexibility to vary annual contribution • Easy to operate • No annual Form 5500 required	• Easy to operate • No annual Form 5500 required • Employees may contribute pretax	• Generous contribution (and deduction) limits • Quicker buildup of benefits	• Traditional IRA: Contributions may be tax deductible • Roth IRA: Withdrawals may be tax free; no lifetime minimum distributions required
Potential Drawbacks	• May require special non-discrimination testing each year	• Actuarial services required • Employer bears investment risk • Annual Form 5500 required	• Annual Form 5500 required	• Same contribution % for all eligible employees • Full immediate vesting • No loans permitted	• No Roth contributions • Full immediate vesting • No loans permitted	• Actuarial services required • Employer bears investment risk • Complex administrative requirements	• Low annual contribution limits
Contribution Types	• Employee/ employer (flexible)	• Employer only	• Employer only	• Employer only	• Employee/ employer (mandatory)	• Employer only (generally)	• Individual only
Contribution Limits (2019)	• Employee pretax/Roth: $19,000 ($25,000 with catch-up) • Annual additions: $56,000 ($62,000 with catch-up) or 100% of compensation, if less • Maximum deduction: 25% of eligible compensation	• Based on actuarial calculations	• Annual additions: $56,000 or 100% of compensation, if less • Maximum deduction: 25% of eligible compensation	• Employer: lesser of $56,000 or 25% of eligible compensation, if less	• Employee pretax: $13,000 ($16,000 with catch-up) • Employer: match 3% of compensation or contribute 2% of eligible compensation	• Annual benefit: $225,000 • Actuarial assumptions apply	• Employee pretax/ Roth $6,000 with $1,000 catch-up contribution



Christopher E. Foster, CIMA, CRPS

Partner
Managing Director

Chris has over 10 years of industry experience and prior to co-founding Procyon Partners, Chris served as a Senior Wealth Strategist, Institutional Analyst, and Senior Retirement Plan Consultant for the FDG Group at UBS Financial Services. He was also a member of the firm's Institutional and Retirement Plan Consulting Groups. As a Partner at Procyon, he leads the firm's investment analyst group while helping clients understand how analytics, retirement plan design and fiduciary best practices can help improve employee retirement outcomes and mitigate organizational risk. Chris is a graduate of the University of Connecticut and holds a B.S. degree in Finance and a B.A. degree in Political Science.

He has earned designations as a Certified Investment Management Analyst (CIMA®) through the University of Pennsylvania's Wharton School of Business and a Certified Retirement Plans Specialist (CRPS®) through the College for Financial Planning.℠ He works with both qualified and non- qualified plans sponsored by many of the nation's top companies, who leverage his expertise in portfolio construction, investment manager research, and fiduciary governance. Chris was recognized by the National Association of Plan Advisors (NAPA) as one of their Top 50 Advisors Under 40 (a.k.a. "young guns") in 2016, by Barron's as one of their Top 30 Institutional Consultants in 2017, 2016 and 2015, and also by plansponsor magazine as a member of their 2011 Retirement Plan Advisory Team of the Year.

Chris is also a member of the Investments and Wealth Institute, a national industry association responsible for establishing and enforcing high fiduciary standards for Investment Consultants. He enjoys traveling, skiing and playing golf, and currently resides in Wallingford, Connecticut with his wife Lauren and their French Bulldog named Gus.

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