# Establishing a Qualified Retirement Plan

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Qualified retirement plans can be adopted by corporations, partnerships, LLCs and self-employed individuals. The employer (or "plan sponsor") is responsible for four basic steps for setting up a retirement plan:

- Adopting a written plan
- Investing the plan assets
- Developing a recordkeeping system
- Providing plan information to participants

## Adopting a written plan

- **Set-up deadline.** To take a deduction for contributions made for a tax year, the plan must be set up (adopted) by the last day of that tax year.
- **Written plan requirement.** To qualify, the plan must be in writing and must be communicated to the employees.
- **Credit for startup costs.** The employer may be able to claim a general business tax credit for part of the startup costs, up to a maximum of $500 per year for each of the first 3 years of the plan. To determine eligibility see IRS Form 8881.
- **Form of Document.** Documents can either be individually designed or pre-approved by the IRS (volume submitter or prototype). Fees apply for individual IRS approval.

## Investing the plan assets

- **Trust or custodial account.** The employer and the trustee are responsible for arranging how the plan's funds will be invested to build its assets.
- **Plan assets must not be diverted.** As a general rule, the assets can not be assigned or diverted to the employer. The plan must make it impossible for its assets to be used for purposes other than the exclusive benefit of employees and their beneficiaries. Continually monitoring the investment options ensures that the selections remain in the best interests of the plan and its participants.
- **Defined Contribution Plans.** Defined contribution plan assets may be invested on a pooled basis (all participants' accounts invested together as a group), with the investments directed by the plan trustee, or participant directed (participants select from investments chosen by the fiduciaries of the plan).
- **Defined Benefit Pension Plans.** Assets are required to be invested on a pooled basis.

## Developing a Recordkeeping System

An accurate recordkeeping system helps track and properly attribute contributions, earnings and losses, plan investments, expenses, and benefit distributions in participants' accounts. If the employer has a contract administrator or financial institution assist in managing the plan, that entity typically will help in keeping the required records. In addition, a recordkeeping system will help the employer, plan administrator, or financial provider prepare the plan's annual return/report that must be filed with the Federal government.

 

## Providing Information to Plan Participants

Employees who are eligible to participate in the plan must be notified about the plan's benefits and requirements. A summary plan description, or SPD, is the primary document to inform participants and beneficiaries about the plan and how it operates. In order to ensure compliance, it is recommended that the SPD be distributed to all employees regardless of their eligibility to participate. If any information contained in the SPD changes, the participants must be notified of the change.

## Types of Qualified Plans

There are two general types of pension plans: Defined Benefit Pension Plans and Defined Contribution Plans. Defined benefit plans provide a specific benefit at retirement for each eligible employee, while defined contribution plans specify the amount of contributions to be made by the employer toward an employee's retirement account. In a defined benefit pension plan the investment risk is born by the employer. In a defined contribution plan the actual amount of retirement benefits provided to an employee depends on the amount of the contributions as well as the gains or losses of the account.

### Defined Contribution Plans:

- Profit Sharing
- Money Purchase Pension
- 401(k)
  - Traditional
  - Safe-Harbor
  - Roth

### Defined Benefit Pension Plans:

- Traditional Defined Benefit Pension
- Cash Balance Defined Benefit Pension

## Tax Advantages of a Qualified Retirement Plan

As long as the qualification requirements of the Internal Revenue Code are met:

- The employer can take a current business expense deduction (within limits) for its contributions to the plan, while the employees are not currently taxed on these contributions.
- Employees pay no tax on employer contributions and fund earnings until benefits are distributed.
- Distributions meeting certain requirements may be eligible for rollover or special tax treatment.
- Earnings on plan investments compound on a tax free basis.

## Other Advantages

- Employee recruiting and retention is enhanced.
- Employer contributions may be deposited up to the due date of the employer's tax return (including extensions) and deducted on the prior year's tax return. However, employer contributions to Defined Benefit and Money Purchase Pension Plans must be deposited no later than 8½ months after the plan year end, regardless of the extended due date of the tax return. Employer contributions to Defined Benefit and Money Purchase Pension Plan can be split between two tax years.
- A vesting schedule can be applied to most employer contributions.
- Funds can be self-trusteed. The plan sponsor/trustee has a large variety of investment options to choose from. Care must be taken to comply with Department of Labor regulations.
- Loans are permitted (subject to restrictions on amount and method of repayment).
- Retirement plan assets are protected against creditors during bankruptcy proceedings by exempting those assets from the debtor's bankruptcy estate, and general creditor protection is available as long as the plan covers at least one non-owner employee (other than a spouse).