TYPES OF QUALIFIED RETIREMENT PLANS

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I. WHY CHOOSE A QUALIFIED PLAN?

A qualified plan provides an exception from the general rules requiring matching of the timing of income inclusion and deduction.

In the case of a tax qualified retirement plan, contributions to the plan which are allocated to a participant's account are currently deductible by the employer, subject to certain limits on the amount of the deduction, but are not currently taxable to the employee. This is the case even if the employee/participant is 100% vested in the contributions.

A tax qualified plan has advantages for both the employer and the employee/participants.

With respect to the employer, in addition to the advantage of the mismatching of the timing of income inclusion to the employee and deduction to the employer, the cash basis employer has an additional advantage. Contrary to the general rule that a cash basis employer is allowed a deduction for amounts actually paid during the taxable period, in the case of a qualified plan, the employer has an extended period in which to make a tax deductible contribution. Specifically, all employers have until their tax filing time, including extensions, to contribute a deductible contribution which will then be treated as deductible for the prior plan year, that is, for the year for which made rather than for the year in which the contribution was actually made. [IRC §404(a)(6)].

Example: A corporation maintains a tax qualified plan. Both the plan and the employer operate using an April 1 to March 31 year. This means that absent an extension, the employer has until June 15, 2006 to make a deductible contribution to the plan which will be deductible for the prior tax year, that is, for the employer's tax year ending March 31, 2006.

In addition, both the employer and the employee may benefit from the tax deferred accumulation under the plan with the party that benefits the most depending upon the type of plan involved.

In addition, the employee/participant has the advantage of favorable tax treatment upon distribution from the plan.

II. CHOOSING AN APPROPRIATE PLAN

A. Defined Benefit or Defined Contribution

The most basic decision which must be made is whether to adopt a defined contribution plan or a defined benefit plan. Each plan type has its own advantages and disadvantages.

In a defined contribution plan, each participant has an individual bookkeeping account to which is credited the participant's share of contributions, forfeitures and investment gains or losses. Having an individual account makes it easier to explain the plan to participants. That is, participants can be told at any given point exactly what their interest is under the plan. Essentially, in the case of a defined contribution plan, it is the employer's contribution that is the "defined" or determined portion of the plan. What a participant is to receive from the plan will depend upon what the employer's contributions and forfeitures allocated to the participant's account will bring, increased or decreased by the participant's share of earnings or losses of the plan's investments. As such, while the contribution is "defined" or determined, the ultimate benefit which the participant will receive is unknown. Because the employee will receive only what is in his/her account at retirement, or termination of employment, the employee bears the risk of investment gain or loss in such plans. That is, to the extent that investment results are good, such will inure to the benefit of the participant and increase the value of the participant's account. Where the investments lose money, the participant's ultimate benefit will be similarly decreased.

Defined contribution plans can be structured to allow participants to direct the investment of their own accounts. This may prove very appealing to employees. However, it can also prove expensive to maintain. In addition, because defined contribution plans consist of individual accounts for each participant, participant loan programs can be relatively easily structured and can be drafted to allow as its only form of acceptable collateral the borrowing participant's remaining vested interest under the plan.

In the case of a defined benefit plan however, no individual bookkeeping accounts are established under the plan. This type of plan is analytically just the opposite of a defined contribution plan. That is, under a defined benefit plan, the employer promises each participant a certain level of retirement benefit provided the employee remains employed until the normal retirement age under the plan. This means that in the case of a defined benefit plan, it is the ultimate benefit that is the "defined" or determined portion of the plan. How we are to get to that level of benefits, that is, the level of contributions required each year to provide the promised benefit, is the unknown portion. Because the employer has promised a level of benefits at retirement, the employer bears the risk of investment gain or loss. Thus, investment losses will only serve to increase the employer's level of funding and investment gains will reduce the contributions required under the plan.

B. Considerations in Deciding Which Generic type of Plan to Adopt

The determination of which type of plan to adopt, i.e., defined benefit or defined contribution, will depend upon a number of factors including the ages and compensation histories of those employees the employer wishes to primarily benefit; the level of contributions the company can afford; the profit history of the company; the company's comfort level with funding contributions and particularly, the level of comfort with required contributions, as well as, how long the plan is expected to remain in existence. In addition, the administrative cost of maintaining each type of plan should be considered.

1. Age Considerations

Generally, a defined benefit plan provides a better vehicle for rewarding older employees. This is because the closer an individual is to the plan's retirement benefit, the shorter the period the company has to fund the promised retirement benefit. In a company that has an older owner that is to be the primary beneficiary of a retirement plan with generally younger lower paid workers, the company's contributions can be used more efficiently with a larger portion of the contributions going to fund the benefits for the older owner. Similarly, with a larger employer, older employees will benefit more from a defined benefit plan although the cost to the company will be more than in a defined contribution plan.

On the other hand, generally, defined contribution plans (with the exception of target benefit plans, new comparability and age-weighted profit sharing plans) are not age-based but rather provide benefits based exclusively on each participant's compensation. A defined contribution can be used to benefit the employer's higher-paid workers without regard to the ages or length of service of those employees.

(Note that, for purposes of the following Examples, I am using compensation of up to $200,000 for ease of calculation and maximum contribution amounts of $40,000. However, under the Code, both figures are subject to cost of living increases such that the maximum compensation that can be taken into account under the plan for 2009 is $245,000 and the maximum dollar limit that can be allocated to a participant's account for 2009 is $49,000)

Example: Assume a corporation employs three individuals, Chris age 55 has annual compensation of $200,000; Leslie, age 45, has annual compensation of $50,000 and Pat, age 25, has annual compensation of $25,000. The company is looking at adopting a retirement plan and is currently considering a defined benefit plan and a profit sharing plan under which contributions, if any, each year would be allocated in the ratio that each participant's compensation bears to total eligible compensation under the plan. The company has engaged the services of a consultant to provide an analysis of how such options would look and the results reported are as follows:

Participant	Defined Benefit (1st years pension cost)	Profit Sharing
Chris (age 55)	$95,351	$40,000
Leslie (age 45)	27,087	10,000
Pat (age 25)	3,971	5,000
	$126,409	$55,000

2. Concerns Regarding the Level of Funding

IRC §415 imposes maximum contribution and benefit limits which an individual may receive from plans maintained by an employer. Because of the way in which the Code Section 415 limits work, a defined benefit plan can be used to provide substantially greater benefits, on a current cost basis, than under a defined contribution plan. As such, defined benefit plans are used quite often when the company is looking to provide relatively large contributions. This is particularly the case where most of the employees of the business who will be the participants in the plan are owners of the company or other family members.

However, a defined benefit plan can provide unexpected increases in contributions from year to year. This may be the case, for example, where older employees' salaries increase substantially or the plan experiences investment losses. Contributions may increase to a level which is no longer comfortable for the company. For this reason, defined benefit plans should ordinarily not be established where the company has a relatively short history of earnings or where cash flow is erratic.

On the other hand, absent the hiring of additional employees, because defined contribution plans can be structured to provide contributions solely as a percentage of each employee's compensation, the level of funding can be easily anticipated and planned for by the company. As indicated above, investment earnings or losses will not affect the company's funding under a defined contribution plan.

3. Cost of Maintaining the Plan

Defined contribution plans are generally less costly to maintain than their defined benefit plan counterparts. This is due in part because in addition to other professionals, i.e., attorney and accountant, a defined benefit plan requires the assistance of an actuary. In addition, a defined benefit plan may be required to pay premiums, on a per participant basis, to fund termination insurance through the Pension Benefit Guaranty Corporation thus further increasing the cost of maintaining such plans. This will be true for most defined benefit plans with the most notable exceptions being small defined benefit plans maintained by certain professional service employers and defined benefit plans which benefit solely owners of the business.

4. Rewarding Past Service

A defined benefit can be structured to provide benefits for service prior to the adoption of the plan. Thus, the fact that the company did not maintain a defined benefit plan throughout most of a participant's working career will not totally preclude the company from later establishing a defined benefit plan and rewarding that prior service. However, care must be taken to ensure, however, that the granting of past service benefits does not impermissibly discriminate in favor of highly compensated employees. [IRC §401(a)(4)].

In the case of a defined contribution plan, rewarding of pre-participation or other past service cannot be done to any efficient degree.

5. Mandatory versus Discretionary Contributions

Generally, a contribution will be required to be made by the employer each year it maintains a defined benefit plan. Failure to make the required contribution will subject the employer to an excise tax under the minimum funding rules. The excise tax is initially 10% of the amount of the underfunding but can increase to 100% of such amount. [IRC §4971] In addition, if the employer attempts to terminate a defined benefit plan, it may find itself confronted with unexpected additional funding required to terminate the plan even if all required contributions have been made to the plan on an on-going basis.

However, if a profit sharing defined contribution plan is established, then absent a provision in the plan to the contrary, contributions to the profit sharing plan will be discretionary. [McClintock-Trunkey Co. v. Comm., 217 F. 2d 329 (9th Cir. 1954)] It should be noted that other types of defined contributions will require a contribution as discussed below.

6. Maximum Contributions or Benefits

The Code imposes restrictions on the maximum amount of benefits or contributions that can be provided by an employer on behalf of a participant during a limitation year. The manner in which these limits apply depend upon whether the plan is a defined contribution plan or a defined benefit plan.

In the case of a defined benefit plan, these limits, contained in Section 415, provide that the maximum benefit payable in the form of a single life annuity cannot exceed the lesser of $160,000 (indexed for cost of living increases–$195,000 in 2009) or 100% of the participant's highest three year average of compensation. [IRC §415(b)] This maximum benefit limit is reduced where benefits become payable prior to age 62.

In the case of a defined contribution plan, the maximum amount that can be allocated to a participant's account for a limitation year cannot exceed the lesser of $40,000 (indexed for cost of living increases–$49,000 in 2009) or 100% of the participant's compensation. [IRC §415(c)]

III. SPECIFIC TYPES OF DEFINED CONTRIBUTION PLANS

Assuming that the employer decides to adopt a defined contribution plan, it must then determine what specific type or types of defined contribution plans to adopt. The primary types and distinguishing features are discussed below:

A. Profit Sharing Plans

1. General Description and Features

First, it should be noted that an employer can contribute to a profit sharing plan without regard to the existence of current or accumulated profits. [IRC § 401(a)(27)(A)] As such, even a tax exempt employer may establish a profit sharing plan.

The most distinctive feature of a profit sharing plan is its contribution flexibility. That is, the plan may be designed to allow the employer to decide from year to year whether it wants to make a contribution, and if so, the level of the contribution. [See, e.g. McClintock-Trunkey Co. v. Comm., 217 F. 2d 329 (9th Cir. 1954)] However, in order to avoid a de facto termination of a profit sharing plan, contributions must be recurring and substantial. [Treas. Reg. §1.401-1(b)(2)]

Profit sharing plans may allow in-service withdrawals. That is, unlike other plans which may only make distribution upon termination of employment, attainment of the plan's normal retirement age or plan termination, a profit sharing plan may be drafted to allow distribution while an employee remains employed. A profit sharing plan may allow distributions after a fixed number of years (i.e., after contributions have been in the plan for at least two years [See Rev. Rul. 71-295, 1971-2 C.B. 184], the attainment of a stated age, or upon the occurrence of a stated event such as layoff, illness or disability. [Treas. Reg. § 1.401-1(b)(1)(ii)] The plan may also allow in-service withdrawals upon the occurrence of a bona fide hardship. [See Rev. Rul. 71-224, 1971-1 C.B. 124]

A simple profit sharing plan is generally very easy to communicate to employees, easy to administer and unless the plan allows for participant-direction of investments, will generally be among the least expensive to maintain. Such plans are often adopted as the initial foray into the world of qualified plans by an employer. Moreover, because of the contribution flexibility, a discretionary profit sharing plan is particularly attractive where the employer is relatively new in business or otherwise has a history of erratic profits.

2. Employer Deduction

Prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001, as a trade off for the contribution flexibility, profit sharing plans offered the lowest level of deductibility for the employer. Subject to certain pre-1987 carryforwards which an employer might have been able to use, generally, the maximum contribution which an employer could deduct was limited to 15% of the aggregate eligible plan year compensation. [IRC § 404(a)(3)]. To the extent that the level of deductible contributions was of concern, such plans could be combined with other types of plans discussed below to alleviate that concern.

However, as a result of EGTRRA (that is, the Economic Growth and Tax Relief Reconciliation Act of 2001), this ceases to be a concern. Specifically, effective for years beginning after December 31, 2001, the maximum deductible contribution limit is increased to 25% of aggregate participant compensation. [IRC §404(a)(3)] Further, elective deferrals will no longer count towards this limit. This means that such before-tax contributions will be separately deductible and will not count against the 25% limit. Finally, for purposes of determining this maximum limit, each participant's compensation includes the participant's elective deferrals, that is, before-tax contributions to a Section 401(k) feature and/or to a Section 125 Cafeteria plan.

3. Maximum Individual Allocations

As a defined contribution plan, starting in 2002, the maximum amount which can be allocated to a participant annually is the lesser of $40,000 (increased for cost of living increases–$49,000 in 2009) or 100% of the participant's compensation. [IRC §415(c)(1)]

4. Allocation Formulas

Over the last several years, there have developed a number of different allocation formulas which may be used under a profit sharing plan. An allocation formula is merely a method of dividing any employer contribution among eligible participants. Although contributions under a profit sharing plan may be discretionary, the plan, as a condition of tax qualification, must maintain a definite allocation formula. [Treas. Reg. §1.401-1(b)(1)(ii)] The following are some of these available allocation formulas.

a. Proportionate to Compensation

A profit sharing plan may provide that company contributions, if any, are allocated in the ratio that a participant's compensation bears to total compensation of all eligible participants' for the plan year. Such an allocation provides for the same percentage allocation for all participants:

> Example: Assume the same facts as in the prior Example. That is, assume a corporation employs three individuals, Chris age 55 has annual compensation of $200,000; Leslie, age 45, has annual compensation of $50,000 and Pat, age 25, has annual compensation of $25,000. The company adopts a profit sharing plan. The plan's allocation provision is as follows:

"For each plan year that a contribution is made, it will be allocated among eligible participants in the same proportion that an eligible participant's Plan Year Compensation bears to the total Compensation of all eligible participants for the Plan Year."

Based upon participant compensation, the company's contribution of 20% of total eligible compensation, (that is, 20% of $200,000 + $50,000 + $25,000 or 20% of $275,000 = $55,000) is allocated as follows:

Participant	Age	Comp	Proportionate to Compensation
Chris	55	$200,000	$40,000
Leslie	45	50,000	10,000
Pat	25	25,000	5,000

b. Formula taking into consideration Permitted Disparity

In lieu of allocating contributions using a proportionate allocation formula, a profit sharing plan may provide for an allocation formula that takes into consideration permitted disparity under the rules of IRC § 401(l).

Permitted Disparity allows the employer to allocate contributions under the plan taking into consideration the fact that the employer already contributes to part of the employee's ultimate retirement when it contributes it's share of the Social Security tax. As a result, Permitted Disparity allows the plan to skew more of the contributions towards those employees whose compensation exceeds the plan's integration level (generally, the Social Security Taxable Wage Base) in recognition of the fact that Social Security replaces a disproportionately greater percentage of pre-retirement compensation for lower paid workers than for their higher paid counterparts.

Example: Assume the same facts as in the prior Example. That is, assume a corporation employs three individuals, Chris age 55 has annual compensation of $200,000; Leslie, age 45, has annual compensation of $50,000 and Pat, age 25, has annual compensation of $25,000. The company is looking at adopting a retirement plan for the 2007 calendar year/plan year. It has decided to adopt a profit sharing plan. It is attempting to decide upon the plan's allocation formula and is deciding between a traditional allocation under which contributions, if any, each year would be allocated in the ratio that each participant's compensation bears to total eligible compensation under the plan or an formula that takes into consideration permitted disparity using the Social Security Taxable Wage base in 2007, i.e., $97,500, as the plan's integration level. The same consultant previously engaged has calculated the following alternative:

			Proportionate	
Permitted				
Participant	Age	Comp	Compen.	Disparity
Chris	55	$200,000	$40,000	$40,000
Leslie	45	50,000	10,000	8,540
Pat	25	25,000	5,000	4,270

c. Profit Sharing Plan with Points Allocation

A Points Profit Sharing Plan is essentially a profit sharing plan that allocates contributions not only on the bases of compensation, but also taking into consideration age and/or service. Under a points allocation formula, contributions are allocated for age or service as well as, but not required, for compensation.

The plan must allocate amounts under a uniform points allocation formula. A uniform points allocation formula means a formula that defines each employee's allocation for the plan year as the product of the total of all amounts taken into account under the plan multiplied by a fraction, the numerator of which is the employee's points for the plan year and the denominator of which is the total of all employees' points under the plan for the plan year. An employee's points for a plan year equal the sum of the employee's points for age, service and units of plan year compensation for the plan year. Each employee in the plan must receive the same number of points for each year of age, the same number of points for each year of service, and the same number of points for each unit of plan year compensation. A plan is not required to grant points for both age and service, but it must grant points for at least one of them. If the plan grants points for years of service, the plan is permitted to limit the number of years of service taken into account to a single maximum number of years of service. A plan need not grant points for units of plan year compensation, but if it does, the unit used must be a single dollar amount for all employees that does not exceed $200. [Treas. Reg. §1.401(a)(4)-2(b)(3)(i)(A)]

In addition, the average of the allocation rates for the highly compensated employees in the plan must not exceed the average of the allocation rates for the non- highly compensated employees in the plan for the plan year. [Treas. Reg. §1.401(a)(4)-2(b)(3)(i)(B)]. This requirement makes the points allocation method virtually useless for most plans.

d. Age-Weighted Profit Sharing Plans

An Age-Weighted Profit Sharing Plan is essentially a profit sharing plan with one unique feature; the manner in which contributions are allocated under the plan are based not only on each participant's level of compensation, but the relative ages of the participants. As such, it is very much like a Target Benefit Plan but with the contribution flexibility of a profit sharing plan.

Under an Age-Weighted Profit Sharing Plan, the plan demonstrates that it is nondiscriminatory by proving that if the contributions being made on a current basis were converted to the ultimate benefits they will produce, the benefits for highly compensated employees would not be discriminatory when compared to the benefits for the non-highly compensated employees under the plan. This is done essentially by determining the annuity that could be purchased with each employee's allocation plus future earnings at the employee's retirement. That is, by taking the allocation for the plan year and projecting it forward with interest as a single sum to normal retirement age and then converting that amount to an annuity. Provided that the annuity, as a percentage of each employee's compensation (i.e., the equivalent benefit accrual rate) is nondiscriminatory, the plan passes the nondiscrimination requirements.

Because younger employees have more years in which their benefits will accumulate prior to retirement, cross-testing, that is, testing contributions as if they were benefits, allows a plan to skew benefits in favor of older workers. To the extent that the older worker population consists of the more highly compensated employees, cross-testing will allow the plan sponsor to skew contributions in favor of the older, more highly compensated employees.

> <u>Example</u>: Assume the same three employees, Chris, Leslie and Pat. Assume that the company is reviewing the desirability of adopting an age-weighted formula with the proposed allocations as follows:

Participant	Compensation	Age-Weighted Allocation
Chris (55)	$200,000	$40,000
Leslie (45)	50,000	5,084

Pat (25)	25,000	750 (top heavy (minimum)

Because of the cross-testing, the plan can skew contributions towards older employees much as would be done in a Target Benefit or defined benefit plan but without the required funding associated with such plans and without the Pension Benefit Guaranty Corporation premium costs associated with most defined benefit plans. As such, these plans may be appropriate where the individuals sought to be primarily benefited are older but where the company does not desire the potentially larger deductions, or the mandatory funding, that could be generated and required with a defined benefit plan.

One disadvantage expressed by many employers with the age-weighted allocation formula is that it provides a benefits-based formula which will likely result in non-uniform contributions for employees performing the same job and the same rate of pay. For example, two seamstresses making $30,000, one age 40 and the other age 20 would receive widely different allocations. Similarly, two physicians of different ages but who share profits equally, would also receive widely different allocations.

e. New Comparability Plans

Another plan design that takes advantage of cross testing is the so called "New Comparability Plan".

A New Comparability Plan is, as was the case with the Age-Weighted Plan, merely a design technique used generally as part of a profit sharing plan. The New Comparability Plan will also allow the skewing of contributions in favor of older employees. However, unlike the Age-Weighted design, the New Comparability allocation formula allows the employer to design a formula which can provide more uniform allocation among employer-designated groups of employees, for example, among all highly compensated employees and/or among all nonhighly compensated employees. Thus, it addresses the primary disadvantage of age weighting. The plan is structured to try and satisfy the general nondiscrimination test and will often provide multiple allocation formulas. Thus, such plans can alleviate the concerns that some employers have with age-weighting whereby employees performing the same jobs receive widely differing allocations. New Comparability can also serve a similar need where the individuals sought to be primarily benefited are themselves of widely differing ages.

No single plan design constitutes a New Comparability Plan. However, such plans may be structured to provide a uniform allocation for all highly compensated employees at a rate which has already been determined to translate into an equivalent or lower accrual rate than that for certain younger non-highly compensated employee that will allow the highly compensated employees to receive the targeted contribution while also passing the nondiscrimination test. However, unlike an Age-Weighted Plan, the plan's allocation formula will be contribution based. For example, a typical New Comparability formula might provide as follows:

> 10% of the Plan Year Compensation for each eligible participant who is a member of Group A; 5% of the Plan Year Compensation for each eligible participant who is a member of Group B, and 3% of the Plan Year Compensation for each eligible participant who is member of Group C. The members of Group A shall consists of all eligible participants who are senior partners of the Employer; the members of Group B shall consists of all eligible participants who are junior partners of the Employer, and the members of Group C consists of all other eligible participants who are not members of either Group A or Group B for the Plan Year.

These plans have the advantage of being able to provide the same level of contribution, as a percentage of current compensation, to all similarly situated employees, possibly even all non-highly compensated employees and/or possibly among all highly compensated employees. This is often more palatable to employees than the results under an Age-Weighted Plan.

New Comparability plans have become, by far, the most popular new design for small company profit sharing plans.

> Example: Assume the same three employees, Chris, Leslie and Pat. Assume that the company is reviewing the desirability of a New Comparability allocation formula as follows:

Participant	Compensation	New Compara.
Chris (55)	$200,000	$40,000
Leslie (45)	50,000	2,500
Pat (25)	25,000	1,250

Note, however, that the Service has issued regulations which require a minimum allocation in the case of non-highly compensated employees under a new comparability plan generally equal to 1/3 of the accrual of that of the highly compensated employee with the highest accrual or 5% of the participant's 415 compensation. The 5% rule essentially becomes a safe harbor where the highest accrual rate for a highly compensated employee is 15% or greater.

B. Money Purchase Pension Plans

1. General Description and Features

Unlike a Profit Sharing Plan, the employer does not have contribution flexibility in the case of a Money Purchase Plan. Rather, the plan must specify the level of contributions to be provided under the plan pursuant to a fixed formula. The contribution is usually expressed as a percentage of each employee's compensation.

For example, a typical Money Purchase Plan formula might provide that contributions shall be allocated to the account of each eligible participant in an amount equal to 10% of the participant's Plan Year Compensation.

The contribution, once specified, must actually be made by the employer or the employer will incur an excise tax initially equal to 10% of the amount of the missed contribution but which can increase to 100% of said amount. [IRC § 4971].

A money purchase plan may not provide for in-service withdrawals prior to the time the participant attains the plan's normal retirement age. [Treas. Reg. § 1.401-1(b)(1)(i)]

Note: Money Purchase Plans may also take advantage of the Age-Weighted or New Comparability formulas normally seen in profit sharing plans.

2. Employer Deduction and Maximum Individual Allocations

While a money purchase plan lacks the contribution flexibility of a profit sharing plan, prior to EGTRRA, it allowed an employer to provide larger contributions, and thus, to receive a larger deduction, than under a profit sharing plan. Post EGTRRA, the money purchase plan is subject to the same deduction limit as applicable to profit sharing plans. Specifically, the maximum deductible contribution is also limited to 25% of aggregate participant compensation for the plan year under the plan. [IRC §404(a)(3)(A)((v)] Moreover, as is the case with profit sharing and stock bonus plans, the maximum amount that can be allocated to each individual participant's account, taking into consideration all defined contribution plans of the employer, is the lesser of $40,000 (increased for cost of living increases) or 100% of the participant's compensation. [IRC §415(c)(1)]

Since profit sharing plans are now subject to the same deduction limit, many employers no longer find a need for a money purchase plan.

3. Advantages, Uses and Limitations

As indicated above, the Money Purchase Pension Plan previously had the advantage of allowing the employer to make larger contributions on behalf of each participant and thus to also receive a larger deduction. However, because the contribution is fixed and is required, the employer might be hesitant to commit itself to a contribution of 15%, 20% or 25%. As such, many employers would adopt both a Money Purchase and a Profit Sharing Plan with the Money Purchase requiring a less than maximum contribution (often structured to provide a contribution at the 10% level or a contribution formula which takes into consideration Permitted Disparity) with the Profit Sharing Plan then being available as a vehicle in any given year to allow the employer to contribute up to an additional 15% of Plan Year Compensation. However, in years of less profitability, the employer would only be required to contribute the amount required under the Money Purchase Plan, that is, in this example, 10% or the amount required under the Money Purchase formula taking into consideration Permitted Disparity.

Given the increase in the maximum deductible contribution to a profit sharing plan and the level of contribution flexibility available to a profit sharing plan, the need to supplement that plan with a money purchase plan is gone for many if not most employers.

C. Section 401(k) Plans

1. General Description and Features

These plans are usually profit sharing plans with one unique feature, i.e., a Section 401(k) deferral provision. Under the Section 401(k) feature, employees are allowed to elect to contribute a part of their compensation, on a before-tax basis, to the plan. [IRC § 401(k)(2)] Thus, the employer gains the advantage of having employees contribute towards their own retirement (often times allowing the employer to then reduce the contribution it may previously have been providing under a pension or other plan) while also allowing employees to reduce their taxable income.

The ability of highly compensated employees to contribute to such plans is generally dependent, under complicated nondiscrimination rules, upon the degree of non-highly compensated employee participation and contributions. As such, many employers will provide for matching contributions with respect to such contributions in order to provide incentives for employee before-tax contributions. As an alternative, the employer may effectively buy its way out of having to satisfy those nondiscrimination rules by providing certain minimum contributions for non-highly compensated employees. [IRC §401(k)(12)] By so doing, the highly compensated employees would no longer be restricted by the failure of the non-highly compensated employees to contribute or to contribute at significant levels.

2. Generally No In-Service Withdrawals

Contrary to the general rules discussed above which allow in-service withdrawals under a profit sharing plans, employee before-tax contributions may generally not be distributed in-service but rather, are subject to very restrictive withdrawal rules. Distributions attributable to an employee's before-tax contributions may not be made before the participant's retirement, death, disability, severance from employment, attainment of age 59 1/2, if the plan so provides or, hardship, again if the plan so allows. [IRC § 401(k)(2)(B)]

3. Advantages, Uses and Limitations

Section 401(k) plans can provide an excellent means of both reducing the employer's plan cost while also getting employees actively involved in the cost of their own retirement. Because such plans are essentially profit sharing plans, they are subject to the same limitations on the employer deduction and maximum allocations for participants as discussed above with respect to profit sharing plans in general. This can prove particularly beneficial in the case of the sole owner and sole employee of a company.

> Example: Assume that Pat is the sole owner and sole employee of ABC Corporation. Pat has annual compensation of $50,000 and decides to establish a profit sharing plan. Under the profit sharing plan, ABC could contribute and deduct up to $12,500, that is 25% of Pat's compensation of $50,000. If instead, ABC establishes a profit sharing plan with a Section 401(k) feature, ABC could still contribute $12,500 to the plan for Pat's behalf. In addition, Pat could contribute, on a before-tax basis under the Section 401(k) feature, the maximum annual before-tax limit, $15,500 for 2008 and $16,500 for 2009, so long as, in total the contribution made by ABC to Pat's account plus the contribution made by Pat does not exceed the lesser of $40,000 (indexed for cost of living increases to $46,000 in 2008 and

$49,000 in 2009) or 100% of Pat's before-tax compensation. Further, the before-tax contributions will not count against ABC's maximum deduction limit.

Small employers with multiple employees should not underestimate, however, the time and cost associated with maintaining such plans from an administrative standpoint particularly if employees are allowed to direct the investment of their accounts. Moreover, in the case of a small employer where the highly compensated employees have been accustomed (pre-Section 401(k) adoption) to receiving the Section 415 maximum as an annual allocation, that is, the lesser of 25% of compensation or $30,000 prior to 2002 and the lesser of $40,000 (indexed for cost of living increases, so $46,000 for 2008 and $49,000 for 2009) or 100% compensation starting in 2002 and thereafter, switching to a Section 401(k) plan may not allow them to continue to receive the same level contribution.

D. Target Benefit Plans

1. General Description and Features

A Target Benefit Pension Plan is a defined contribution plan that also has characteristics of a defined benefit plan. Specifically, the Target Benefit Plan has characteristics of both a Money Purchase Plan and of a Defined Benefit Plan. Like a defined benefit plan, the employer establishes a targeted ultimate benefit for each participant. The plan will have a defined benefit type formula usually taking into consideration years of service and compensation. The amount actually allocated to a participant's account is based upon the amount necessary to fund the targeted benefit funded on a level basis over the employee's career. However, like a Money Purchase Plan, what the employee actually receives from the plan is whatever can be provided by the participant's account at the time of the triggering event, i.e., termination of employment, retirement or otherwise.

As is the case with a defined benefit plan, the contribution is determined taking into consideration certain assumptions, the most important of which is the expected return on investments. As is the case with a defined benefit plan, contributions for younger employees will be smaller because of the more years in which the contributions will have to accumulate and earn interest.

Unlike a defined benefit plan, future contributions do not reflect investment gains or losses. As is the case with other defined contribution plans, the employee in a target benefit plan bears the risk of investment gains or losses. To the extent that the plan investments perform better than expected, the employee's ultimate benefit will be increased. However, to the extent that investments perform more poorly, contributions are not increased and the employee's ultimate benefit will not meet the target.

No contribution flexibility is available to the employer under the plan and the contribution, once determined, is required to be made.

The same deduction limitations as apply to a profit sharing and money purchase plans apply to the Target Benefit Plan.

2. Advantages, Uses and Limitations

An employer might choose this type of plan when it wants the age considerations under a defined benefit plan in order to shift more of the benefits to older workers but is content with the maximum level of deductions and contributions available under a Money Purchase Plan and the employer does not want the on-going actuarial cost and added administration of maintaining a defined benefit plan. Because the Target Benefit Plan provides for only a targeted benefit and not a promised benefit as would be the case under a defined benefit plan, the Target Benefit Plan does not suffer from the unexpected contribution increases that may result from actuarial losses in the case of a defined benefit plan. However, because the Target Benefit Plan is subject to the maximum contribution limits of Section 415(c) rather than the maximum benefit limits of Section 415(b), older employees will likely receive lesser benefits, determined on a current contribution basis, than if a defined benefit plan had been established at the same point in time.

IV. THE CASH BALANCE PENSION PLAN

A. General Description and Features

A Cash Balance Plan is a type of defined benefit plan that also has features of a defined contribution plan.

A Cash Balance Plan looks very much like a defined contribution plan. That is, individual hypothetical bookkeeping accounts are established for each participant. The use of individual accounts makes such plans easier to communicate to employees and for employees to appreciate than the traditional defined benefit plan. Like a defined contribution plan, the account is increased by hypothetical employer allocations and earnings. However, the plan is funded like a defined benefit plan.

In designing a Cash Balance Plan, the employer must decide upon the rate of the hypothetical allocations as well as the rate of the hypothetical interest credits. It must be remembered that the bookkeeping accounts are merely a device to keep track of participants' accounts. However, because a Cash Balance Plan is a defined benefit plan, annual contributions are determined actuarially and may be greater than or less than the amounts credited hypothetically to the participants' bookkeeping accounts. The interest rate credited may also be greater or less than the amount of actual earnings. The hypothetical interest rate can be either a flat fixed rate or a rate tied to some independent source such as a consumer price index.

Each employee's normal retirement benefit is based upon the actuarial equivalent of the amount credited to the employee's bookkeeping account as of the date of benefit commencement. The bookkeeping account consists of the compensation credits (i.e., generally a percentage of the employee's plan year compensation) and the interest credit.

The hypothetical interest credits are guaranteed under the plan without regard to what the plan actually earns on its investments. Under such a scenario, the risk of investment loss remains with the employer as is the case with the traditional defined benefit plan.

Cash Balance Plans are subject to the minimum funding requirements of the Code and the Employee Retirement Income Security Act of 1974 (ERISA). Further, the Cash Balance Plan would be subject to the Pension Benefit Guaranty Corporation’s termination insurance program.

B. Advantages, Uses and Limitations

Cash Balance Plans are more attractive to younger workers than the traditional defined benefit plan because benefits are usually more frontloaded, that is, younger shorter service employees will normally receive a greater benefit under a Cash Balance Plan than would be the case under a traditional defined benefit plan. However, the opposite may be true for older workers nearer retirement. Because older workers nearer retirement are by far the most costly group under a pension plan, the savings to the employer of converting to a Cash Balance Plan may prove significant even taking into consideration the relatively larger benefits for younger shorter service workers.

Cash Balance Plans may prove an effective means by which an employer maintaining a traditional defined benefit plan may move out of the defined benefit plan arena altogether. An overfunded traditional defined benefit plan can be converted to a Cash Balance Plan in order to make use of the excess without the excess being deemed taxable to the employer. Since the conversion of the plan from the traditional defined benefit pension to the Cash Balance Plan would not constitute a termination of the plan, the excess would not be treated as having reverted to the employer and no excise tax would be due.

With respect to disadvantages, legislative changes which have the effect of finally resolving many of the outstanding issues pertaining to Cash Balance Plans may also make such plans less attractive to some employers.

Specifically, as a result of the Pension Protection Act of 2006, employers will no longer be able to use the “wear away” technique (pursuant to which, some employees would not accrue any benefits under the new Cash Balance formula until their benefits would have exceeded the benefits under the traditional plan formula) can no longer be used. Rather, with respect to conversions, the Pension Protection Act provides that if, after June 29, 2005, the plan is amended to convert it to a Cash Balance Plan from a traditional defined benefit plan, the plan will be treated as failing to meet the age-discrimination provisions unless the following requirement is satisfied with respect to each individual who was a participant in the plan immediately before the adoption of the amendment. The special rule is satisfied if the accrued benefit of the participant under the terms of the plan as in effect after the amendment is not less than the sum of:

1. the participant’s accrued benefit for years of service before the effective date of the amendment, determined under the terms of the plan as in effect before the amendment, plus

2. the participant’s accrued benefit for years of service after the effective date of the amendment, determined under the terms of the plan as in effect after the amendment.

For purposes of (1) above, the plan is required to credit the accumulation account or similar amount with the amount of any early retirement benefit or retirement-type subsidy for the plan year in which the participant retires, if, as of such time, the participant has met the age, years of service, and other requirements for entitlement to such benefit or subsidy. [IRC Section 411(b)(5)(B)(iii) & (iv)]

Another change resulting from the enactment of the Pension Protection Act requires that participants vest much more rapidly under a Cash Balance Plan than under a traditional defined benefit plan. Specifically, contributions under a Cash Balance Plan must be fully vested no later than after 3 years of service. [IRC Section 411(a)(13)](B)]