

QUALIFIED PLAN STRATEGIES

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Owner-only Retirement Plan Opportunities

The following is intended as an overview of some of the more important aspects of retirement plans for owner-only businesses.

Basic "Owner-only" Options

There are four basic options for business-sponsored plans: SEP, SIMPLE-IRA, 401(k) Plan, and Defined Benefit Plan.

The **SEP**, **SIMPLE-IRA**, and **401(k) Plan** have the advantage of contribution flexibility. Each year the owner has the option to set aside the maximum contribution amount, choose to contribute nothing, or contribute any amount in between.

However, in most cases the maximum contribution is much lower than that available with a **Defined Benefit Plan**. The trade-off for this higher contribution is the DB Plan's relatively fixed contribution schedule.

SEP

Contributions to a SEP are limited to the lesser of 25% of current year compensation or \$45,000 (2007 limit, indexed). This means that an owner of a corporation must receive W-2 wages of \$180,000 or more to reach the \$45,000 maximum.

A SEP has the benefit of low administrative expenses. However, the contribution options are limited.

401(k) Plan

Company contributions to a 401(k) Plan are also limited to 25% of current year compensation.

However, 401(k) Plans have the advantage of allowing an additional \$15,500 of salary deferral (2007 limit, indexed), so long as the total doesn't exceed \$45,000 (\$50,000, if the owner is age 50 or older) or 100% of the owner's compensation.

This allows an owner of a corporation with W-2 wages of less than \$180,000 to contribute more than he or she would have been able to contribute using a SEP.

Other benefits of a 401(k) Plan include the option of making pre-tax Roth deferrals, catch-up deferrals for those age 50 or older (an additional \$5,000), and the option of allowing participant loans.

A 401(k) Plan that qualifies for the 5500-EZ does not need to file the 5500-EZ until assets are over \$250,000 for the year. Please note that this amount includes rollovers into the plan, as well as contributions receivable for that year.

SIMPLE-IRAs

Because of their lower contribution limits, SIMPLE-IRAs are usually not the best option for owner-only businesses (unless the owner's total contribution objectives are below these limits).

Deferrals under a SIMPLE-IRA are limited to \$10,500 (with an additional catch-up deferral of \$2,500 for owners age 50 or older).

Company contributions for an employee are limited to either 3% of compensation (using the match) or 2% of compensation (using the non-elective contribution). This generally means that total contributions are far less than the \$45,000 maximum for the SEP or 401(k) Plan.

Defined Benefit Plans

Annual contributions to a DB Plan can range up to \$200,000 (depending on age and compensation).

This is possible because a DB Plan funds for a benefit at retirement, so the maximum contribution is not directly limited by the owner's current year compensation. Rather, actual compensation limits the maximum benefit at retirement for which the plan can fund.

The closer the owner is to the plan's retirement age, the greater the annual contributions need to be to fund the expected benefit. For this reason, an older owner tends to have higher maximum annual contributions than does a younger owner.

However, annual contributions are relatively fixed. Future contribution targets may be changed through plan amendment, but the owner should assume that he or she will be making similar contributions in future years (the owner should intend to sponsor the plan for at least three years).

Table of Basic Options

	Deferral	Catch-up	Max Contribution
SEP	n/a	n/a	25% or \$45,000
SIMPLE-IRA	\$10,500	\$2,500	2% or 3%*, plus deferrals
401(k)	\$15,500	\$5,000	25% + deferrals Up to \$45,000 (\$50,000 if age 50 or older)
Defined Benefit	n/a	n/a	Up to \$200,000**
DB + 401(k)	\$15,500	\$5,000	Up to \$200,000**

*Company contributions to a SIMPLE-IRA are capped at either 2% or 3% of compensation.

**Maximum DB contribution depends on age and compensation.

Owner-only Defined Benefit + 401(k) Plan

Benetech's most popular retirement program for owner-only businesses is to combine a Defined Benefit Plan and a 401(k) Plan. The 401(k) Plan allows an optional salary deferral contribution in addition to the large Defined Benefit Plan contributions.

Defined Benefit Plan contributions vary with age and compensation. For example, consider two owners of corporations with W-2 wages of \$100,000: one age 40, and the other age 62. There is a substantial difference in the maximum first-year DB Plan contribution for each:

- **\$56,000 for the owner who is age 40.** Deferrals from a 401(k) would allow an additional \$15,500, for a total of \$61,500.
- **\$203,000 for the owner who is age 62.** Deferrals from a 401(k) would allow an additional \$20,500, for a total of \$223,500.

Because of the age dependence of the contribution, **the best candidates for a DB Plan are age 40 or older.**

Examples

Age	W-2 Wages	DB & 401k Contributions	vs.	Owner-only 401(k)	DB Advantage
40	\$65,000	\$81,344		\$31,750	\$49,594
50	\$105,000	\$136,911		\$46,750	\$90,161
60	\$220,000	\$201,070		\$50,000	\$151,070

Note: The Pension Protection Act of 2006 brought changes that allow an additional profit sharing contribution of up to 6% to the 401(k) Plan without affecting the deductibility of the DB Plan contribution. But, this assumes that the DB Plan is being funded at the minimum level. Because of this limitation on funding the DB Plan, the additional 6% profit sharing contribution is not always appropriate.

Three Profiling Questions

For assistance in determining the proper plan design, please contact a Benetech consultant at 800-284-7526.

Is a relatively fixed contribution target acceptable if it results in the ability to save substantially more for retirement?

- **Yes:** Consider a Defined Benefit Plan.
- **No:** Consider a SEP or 401(k) Plan.

Do you want to contribute more than the lesser of 25% of compensation or \$45,000?

- **If "Yes", then:** Is your W-2 compensation less than \$180,000?
 - **Yes:** Consider a 401(k) or a Defined Benefit Plan.
 - **No:** Consider a Defined Benefit Plan.
- **No:** Consider a SEP.

Do you want to make pre-tax Roth contributions?

- **Yes:** Include a 401(k) Plan in your retirement program.

Who Qualifies as "Owner-only"

A business that has no employees other than an owner (or an owner and spouse) qualifies to use the shorter Form 5500-EZ. The EZ requires less reporting than does the standard 5500. For this reason, lower administrative fees may be offered to such clients.

Businesses that Qualify:

- **Any Type of Business:** Sole Proprietorships, Corporations, LLC's, and LLP's can all sponsor any of these plan types; and
- **No employees other than owner, or owner & spouse.**

The instructions for the 5500-EZ are very specific about the type of companies that qualify for the use of the EZ. Some businesses that seem to qualify actually do not qualify to use the EZ.

Businesses that do not qualify:

- **Corporations with unmarried owners.** For example, a corporation that has two unmarried owner-employees and has no other employees does not qualify for the 5500-EZ, and therefore must follow standard reporting requirements.
- **Companies employing children or parents who are eligible for the plan.** For this purpose, an owner's relatives (other than the spouse) are treated the same as common-law employees.
- **Companies that are part of a Controlled or Affiliated Group of companies.** For example, if a husband and wife own separate businesses, but the businesses are considered to constitute a Controlled Group of companies, they do not qualify for the 5500-EZ.

Definition of Compensation

The definition of an owner's compensation depends of the form of the business.

Corporations: Only W-2 wages may be considered compensation for plan purposes. This is true even for "sub-s" corporations.

Sole Proprietors & Partnerships: Self-Employment Income (SEI) is used for plan purposes.

The Next Step

Benetech has a **free contribution illustration** service for owner-only Defined Benefit Plans.

For more information about how a client or prospect might benefit from a retirement plan, please contact your Benetech consultant or call our consulting desk at 800-285-7526.

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