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Comparison of Retirement Plans (excluding Nonqualified Plans)

Payroll Deduction IRA

- May be set up by any employer
- Participant's retirement benefits based on participant's account balance
- Employees may contribute to their own retirement by payroll deduction, up to \$5,000¹ and an additional \$1,000 if age 50 or older
- May cover all employees or selected employees
- Easy to set up and operate
- No annual return required by the employer for the plan
- Annual nondiscrimination testing not required
- Little design flexibility
- Employees may not take loans from the plan
- Employees may withdraw their balance at any time, subject to tax
- Immediate vesting in full account balance

¹Dollar limits are for 2010 & 2011 and are subject to cost-of-living adjustments for future years

N.B. Credit for startup costs. You may be able to claim a tax credit for part of the ordinary and necessary costs of starting a SEP, SIMPLE, or qualified 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 of \$500 per year for each of the first 3 years of the plan.

Simplified Employee Pension (SEP-IRA)

- May be set up by any employer as late as the due date (including extensions) of the company's income tax return for the year you want to establish the plan
- May use the IRS model SEP, Form 5305-SEP, *Simplified Employee Pension – Individual Retirement Accounts Contribution Agreement*, or another plan document offered by the financial institution
- Participant's retirement benefits based on participant's account balance
- Employer can decide each year whether and how much to contribute
- Only the employer is allowed to contribute to the plan on behalf of employees, up to the lesser of 25% of an employee's compensation or \$49,000¹
- Must cover all employees who are at least 21 years of age and have been employed in 3 of the last 5 years with compensation of at least \$550¹
- Easy to set up and operate; special rules for self-employed individuals
- No annual return required
- Annual nondiscrimination testing not required
- Little design flexibility
- Employees may not take loans from the plan

- Employees may withdraw their balance at any time, subject to tax
- Immediate vesting in full account balance

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SIMPLE IRA

- May be established by any employer with 100 or fewer employees and no other retirement plans
- Participant's retirement benefits based on participant's account balance
- Allows employees to contribute to their own retirement through salary deferrals, up to \$11,500¹ and an additional \$2,500¹ if age 50 or older
- Requires the employer to make either matching contributions of up to 3% or a 2% contribution to all participants
- Plan must cover all employees who have compensation of at least \$5,000 in any 2 prior years and are expected to earn \$5,000 in the current year
- No age requirement for participation and no minimum 1 year of service required
- Easy to set up and operate
- No annual return required
- Maintained only on a calendar year basis
- Annual nondiscrimination testing not required
- Little design flexibility
- Employees may not take loans from the plan
- Employees may withdraw their balance at any time, subject to tax and withdrawals within the first 2 years may be subject to an additional 25% early distribution tax
- Immediate vesting in full account balance
- Deadline to establish is January 1st to October 1st of any given year (except for new businesses) provided the plan sponsor did not previously maintain a SIMPLE IRA plan. If a SIMPLE IRA plan was previously established, a SIMPLE IRA plan may be set up effective only on January 1
- You can use Form 5304-SIMPLE or Form 5305-SIMPLE to set up a SIMPLE IRA plan. Each form is a model savings incentive match plan for employees (SIMPLE) plan document. Which form you use depends on whether you select a financial institution or your employees select the institution that will receive the contributions
- Use Form 5304-SIMPLE if you allow each plan participant to select the financial institution for receiving his or her SIMPLE IRA plan contributions. Use Form 5305-SIMPLE if you require that all contributions under the SIMPLE IRA plan be deposited initially at a designated financial institution

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SIMPLE 401(k)

- May be established by any employer with 100 or fewer employees and no other retirement plans
- Participant's retirement benefits based on participant's account balance
- Allows employees to contribute to their own retirement through salary deferrals, up to \$11,500¹ and an additional \$2,500¹ if age 50 or older

- Requires the employer to make either matching contributions of up to 3% or a 2% contribution to all participants
- No more than \$245,000 of the employee's compensation can be taken into account in figuring salary reduction contributions, matching contributions, and nonelective contributions in 2011
- Plan must cover all employees who have compensation of at least \$5,000 in any 2 prior years and are expected to earn \$5,000 in the current year
- May require age 21 and minimum of 1 year of service for participation
- Easy to set up and operate with plan adoption (no government forms for this purpose)
- Usually requires annual return of form 5500
- Annual nondiscrimination and top-heavy testing not required
- Little design flexibility
- Employees may take loans and/or hardship withdrawals if permitted by plan
- In-service withdrawals permitted but subject to possible 10% penalty if before age 59 1/2
- Immediate vesting in full account balance
- Deadline to establish is January 1st to October 1st of any given year except for new businesses

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Safe Harbor 401(k)

- May be set-up by any employer other than a state or local government entity
- Participant's retirement benefits based on participant's account balance
- Allows employees to contribute to their own retirement through salary deferrals, up to \$16,500 and an additional \$5,500 if age 50 or older¹
- Requires the employer to make either matching contributions or a 3% contribution to all participants
- The maximum combined employer and employee contributions are the lesser of 100% of an employee's compensation or \$49,000¹ or more if catch-up contributions
- May exclude certain employees from coverage as long as annual coverage tests are met
- More complex to set up and operate
- Usually requires annual return of form 5500
- Some annual nondiscrimination testing could be required
- Greater design flexibility
- Plan may allow employees to take loans and hardship withdrawals
- Immediate vesting in full account balance

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401(k)

- May be set up by any employer other than a state or local government entity
- Participant's retirement benefits based upon participant's account balance
- Allows employees to contribute to their own retirement through salary deferrals, up to \$16,500¹ and an additional \$5,500¹ if age 50 or older
- Although not required, the employer may contribute to an employee's retirement account up to 25% of compensation (not to exceed limit of \$49,000 or \$54,500 for age 50+)

- The maximum combined employer and employee contributions are the lesser of 100% of an employee's compensation or \$49,000¹ or more if catch-up contributions
- May exclude certain employees from coverage as long as annual coverage tests are met
- More complex to set up and operate
- Usually requires annual return of form 5500
- Must usually satisfy annual nondiscrimination testing
- Greater design flexibility
- Plan may allow employees to take loans and hardship withdrawals
- Immediate vesting in employee's own contributions

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Profit-Sharing

- May be set up by any employer
- Participant's retirement benefits based upon participant's account balance
- May include a 401(k) feature allowing employees to contribute to their own retirement through salary deferrals, up to \$16,500¹ and an additional \$5,500¹ if age 50 or older
- The employer can decide each year whether and how much to contribute
- The maximum annual contributions are the lesser of 25% of an employee's compensation or \$49,000¹ or more if catch-up contributions
- May exclude certain employees provided annual coverage tests are met
- More complex to set up and operate
- Usually requires annual return of form 5500
- Must usually satisfy annual nondiscrimination testing
- Greater design flexibility
- Plan may allow employees to take loans and hardship withdrawals
- May delay vesting of employer contributions

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Defined Benefit

- May be set up by any employer
- Participant's annual retirement benefit determined by the plan's benefit formula
- The maximum annual benefit at retirement is the lesser of \$195,000¹ or 100% of final average pay
- An actuary is required to annually certify the amount the employer must contribute to the plan to fund retirement benefits for the employees
- Must meet minimum coverage tests but can exclude some employees
- Most complex to set up and operate
- Annual return of form 5500 must be filed
- Must satisfy annual nondiscrimination testing
- Greater design flexibility
- Plan may allow employees to take loans
- May delay vesting of participants' accrued benefit

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Section 412(e)(3) Fully Insured Defined Benefit Plan

- A defined benefit plan funded exclusively with a fixed annuity or with a combination of a fixed annuity and life insurance contracts
- No actuary required because funding levels are based on guaranteed insurance values
- All contributions are tax deductible, including life insurance portion of contribution and disability waiver of premium feature
- Self-completing in event of pre-retirement death or disability of participant where life insurance is included
- Retirement benefit in form of annuity

Cash Balance (Hybrid DB & DC) Plan

- A defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance
- A participant's account is credited each year with a pay credit and an interest credit
- Investment risks and rewards on plan assets are borne solely by the employer
- When a participant becomes entitled to receive benefits under a cash balance plan, the benefits that are received are defined in terms of an account balance
- Benefits may be taken as a lump sum as well as an annuity
- A lump sum distribution may be rolled into an IRA

403(b)

- May be set up by public education employers and tax-exempt (501(c)(3)) organizations
- Participant's retirement benefits based on participant's account balance
- Allows employees to contribute to their own retirement through salary deferrals, up to \$16,500¹ and an additional \$5,500¹ if age 50 or older
- May allow certain employees with 15 or more years of service to contribute an additional \$3,000
- Although not required, the employer may contribute to an employee's retirement account
- The maximum combined employer and employee contributions are the lesser of 100% of an employee's includible compensation or \$49,000¹ or more if catch-up contributions or 15 or more years of service contributions
- Covers almost all employees
- Annual return of form 5500 required if employer makes contributions
- Greater design flexibility
- Plan may allow employees to take loans and hardship withdrawals
- Immediate vesting in employee's own contributions

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Retirement Plan Assessment Profile of Client

Demographic of Group

- Single person or married couple working together
- Older owners and younger employees
- Mix of older and younger owners
- Single owner and multiple employees

Goal of Owner

- Maximize owner benefit and minimize employee benefit
- Voluntary employee contributions only (no employer contributions to plan)
- Accelerate contributions for older owner (make up for past years of no contributions)

Magnitude of Money Available for Retirement Plan

- Highly successful owner, ample cash flow
- Affluent middle-class owner
- Keep employees happy enough so they don't leave

Consistency of Cash Flow & Profits

- Highly consistent with track record
- Reasonably consistent with track record
- Intermittently consistent

Time Period Envisioned

- Owners' work life expectancy
- Indefinite life of plan

Other Considerations

- Health condition of owner(s)
- Current retirement plan in place
- Frozen former retirement plan
- Nonqualified retirement plan in place
- Controlled or affiliated group relationships
- Legal entity of organization

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Understanding the Cash Balance Tax-Qualified Retirement Plan

The Cash Balance Plan (CBP) is a hybrid pension plan, that is, it is a defined benefit (DB) plan with attributes of the defined contribution (DC) plan. Traditionally, the DB plan required participants to wait until normal retirement age (usually 65) to receive a benefit, and the benefit took the form of an annuity. Since there was no accounting that could or would segregate the individual participant's account benefit from the pool of DB assets, a participant would have to rely upon the employer/plan sponsor's contributions and investment performance to assure the receipt of a promised retirement benefit.

The CBP is a somewhat different animal from the traditional DB plan on three counts:

- 1) The participant still does not have an allocation to an individual account balance as a DC participant would have, but the Pension Protection Act (PPA) of 2006 introduced a concept that serves as a proxy for an individual account balance. Instead of an actual allocation, the plan sponsor credits amounts on a notional basis to a hypothetical (i.e., bookkeeping) 'retirement balance' for each participant to determine the CBP participant's benefit under the plan. Such 'retirement balance' mimics a DC individual account balance, even though all contributions to the plan are made in aggregate (i.e., not segregated or individually allocated).
- 2) The CBP participant does not have to wait until age 65 (or the plan's normal retirement age) to access his or her benefit. If a participant leaves the employ of a plan sponsor of a CBP, upon termination of employment the participant may take the retirement balance attributed to him or her and roll it over to an IRA or other qualified retirement plan.
- 3) While the CBP must offer at least three annuity options under the plan, unlike in a traditional DB plan a CBP participant may take a payout in a lump sum (in cash or roll into an IRA, etc.) Of course, a participant may elect to take the payout in an annuity form, but generally the lump sum is the preferred payout option.

In sum, a CBP *is* a DB plan, but with the difference that it performs in certain important respects like a DC plan. Why do these differences, and the features typical of a DB plan, make the CBP attractive to employers and employees?

Advantages of a CBP

- 1) The contributions that may be made on behalf of participants are actuarially calculated against the maximum retirement benefit currently allowed of \$195,000 a year. This means that contributions of much higher amounts may be made on behalf of employees, especially older employees.
- 2) The higher contribution rates mean that the tax savings is commensurately greater. Money that would otherwise go to pay current income taxes is retained for the participant's future use during retirement.
- 3) An interest crediting rate is set at the time of plan adoption. Generally this is a risk-free rate based on thirty-year Treasury bonds. Such a rate insulates the 'retirement balance' of a participant from the vagaries of the investment market.
- 4) No loans are permitted from the plan
- 5) Transparency of benefits compared to traditional DB plan
- 6) Portability of benefit when leaving employment
- 7) Ability to rollover benefit to IRA or other tax-qualified retirement plan
- 8) May be coupled with a profit sharing/401(k) plan to increase overall contribution limits (and take advantage of possible increases in equity values)

Disadvantages of a CBP

- 1) Typically requires a significant percentage (around 7%) of compensation to be contributed to non-highly compensated employees (NHCEs)
- 2) The organization adopting a CBP must be able to make consistent contributions for at least three years or more; penalties for premature plan dissolution can be high
- 3) Plan administration costs are higher; actuarial computations are required annually
- 4) The interest crediting rate may be lower than return on equities
- 5) Contributions to Pension Benefit Guarantee Corporation (PBGC) are required

The Bottom Line

Whether the adoption of a CBP (or any other retirement plan design) makes sense depends upon the facts and circumstances of particular cases. An analysis of an organizations' employee census and financials is essential before moving forward.

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Understanding the New Comparability (‘Cross-Tested’) Profit Sharing Plan

The New Comparability Profit Sharing Plan (NCPSP) is a Defined Contribution (DC) plan in the respect that its contribution limits are set by the DC structure (\$49,000 maximum for any individual in 2011). However, a DC plan may be tested for discrimination purposes on the basis of either plan benefits paid at normal retirement age or current plan contributions. When a DC plan is tested on the basis of benefits, it behaves more like a Defined Benefit (DB) plan. The benefits paid are converted using actuarial assumptions to equivalent benefits paid at normal retirement age, and these Equivalent Benefit Accrual Rates (EBARs) are tested in a manner similar to a DB plan (this is the ‘cross-testing’).

Profit Sharing Plan (PSP)

A PSP is one type of DC plan and like other DC contribution plans limits annual plan contributions to 25% of the total compensation of plan participants. Because it is a PSP, contributions to the plan each year are discretionary, a feature that makes this type of plan especially desirable to some business owners (although a plan to remain tax-qualified must be treated as a ‘permanent’ plan). Contributions may be withheld if profits are insufficient, but a PSP allows retirement plan contributions to be made even in a year in which no profits are realized. A plan participant who leaves before the end of the plan year may be excluded from receiving a contribution for that year.

New Comparability Profit Sharing Plan (NCPSP)

This plan design allows different classes of employee/participants to be set up based on criteria such as compensation, years of service, and the like. As a practical matter, owners set themselves up as a separate class from other employees and allocate a much higher percentage of compensation to their retirement contributions. Usually employees in the other class of plan participants must be allocated a minimum of 5% of compensation for the plan to pass muster for nondiscrimination testing. Because the plan uses DB-like allocations, it must be tested each year for nondiscrimination. In the event the testing fails, the plan document must include a ‘definitely determinable’ formula for making the necessary corrections.

401(k) Feature

A 401(k) is a voluntary savings plan under a Profit Sharing Plan. It may be either a stand-alone savings plan or coupled with a Profit Sharing Plan. The 401(k) is known as a CODA (Cash or Deferred Arrangement). It may be used in conjunction with a NCPSP.

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Understanding the Section 412(e)(3) Tax-Qualified Retirement Plan

The section 412(e)(3) [formerly 412(i)] plan is a qualified defined benefit plan funded exclusively with a fixed annuity or with a combination of a fixed annuity and life insurance contracts, each of which must be specifically designed for the purpose of the plan (i.e., not any annuity or life insurance contract will do). Funding levels do not require actuarial certification – they are based on the guaranteed cash values and annuity purchase rates of the products used.

Tax Effects

Contributions are tax deductible, including contributions that pay for the (incidental, i.e., not exceeding 50% of employer contribution) life insurance component, should that be included with the fixed annuity. If a premium rating (i.e., an increased cost of life insurance) is applied to the whole life policy, that additional expense is tax deductible. Participants recognize the cost of the current economic benefit of the life insurance as taxable income each year.

Some Requirements

A Third Party Administrator (TPA)
Written plan document approved by the IRS
Funded exclusively by specific insurance products
Loans from policies not available
Annual tax return (form 5500) required
All eligible employees must be covered by the plan
Vesting schedule is permitted

Unique Features

Self completing in cases of (a) total disability where Waiver of Premium is attached to life insurance component and (b) in pre-retirement death of participant, beneficiary receives death benefit of life insurance free of taxes. No actuary required or PBGC (Pension Benefit Guarantee Corporation) premium required.

At Retirement

Participant receives a monthly income from an annuity. Maximum benefit of \$195,000/yr or percentage of final pay may be received as early as age 62.

Estate Planning Option

Life insurance component may be transferred to an Irrevocable Life Insurance Trust (ILIT).

Downside

Generally a lump sum distribution is not advisable owing to the GATT rate reduction applied to the maximum amount payable in the form of a lump sum.

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Comparison of IRA and Tax-Qualified Retirement Plans

IRA Plans	Tax-Qualified Plans
No annual return required	Annual return generally required
Not a qualified plan	A qualified plan
Government forms available for setup	Adoption of a plan document (not gov't. supplied)
No nondiscrimination testing	Nondiscrimination testing may apply (waived by Safe Harbor)
Inflexible design	Generally flexible design, more latitude possible
Lower contribution limits	Higher contribution limits
Ease of setup and operation	More complex setup and operation
Loans & hardship withdrawals not permitted	Loans & hardship withdrawals may be permitted
Vesting schedule not permitted	Vesting schedule permitted under certain circumstance
Fiduciary rules apply	Fiduciary rules apply, and more complex owing to more complex structure

**Comparison of Retirement Plan Contribution Limits,
Employers and Employees**

Plan Type	Employer Contribution Limit (2011)	Employee Contribution Limit (2011)
Payroll Deduction IRA	N/A	\$5,000 plus \$1,000 age 50+
SEP-IRA	Lesser of 25% of employee compensation or \$49,000	None permitted
SIMPLE IRA	Required: match up to 3% or 2% (nonelective) to all participants	\$11,500 plus \$2,500 age 50+
SIMPLE 401(k)	Required: match up to 3% or 2% (nonelective) to all participants	\$11,500 plus \$2,500 age 50+
Safe Harbor 401(k)	Required: matching up to 3.5% or 3% (nonelective) to all participants Maximum combined employer/employee contributions are lesser of 100% of Ee comp or \$49,000 (\$54,500 age 50+)	\$16,500 plus \$5,500 age 50+
401(k)	No matching or nonelective contribution required Maximum combined employer/employee contributions are lesser of 100% of Ee comp or \$49,000 (\$54,500 age 50+)	\$16,500 plus \$5,500 age 50+
Profit Sharing	Lesser of 25% of compensation or \$49,000	N/A
Solo 401(k) {401(k) + Profit Sharing Plan}	Employer may contribute up to 25% of comp not to exceed limit of \$49,000 or \$54,500 age 50+	\$16,500 plus \$5,500 age 50+
Defined Benefit	Max benefit at retirement is lesser of \$195,000 or 100% of final pay	N/A
403(b) Savings Only	N/A	\$16,500 plus \$5,500 age 50+ Ees with 15 yrs service an additional \$3,000/year
403(b) with Employer Contribution	No matching or nonelective contribution required Maximum combined employer/employee contributions are lesser of 100% of Ee comp or \$49,000 (\$54,500 age 50+)	\$16,500 plus \$5,500 age 50+ Ees with 15 yrs service an additional \$3,000/year
457(b) [Non-Qualified] 501(c) Non-Profits	Employee and Employer contributions permitted, not to exceed \$16,500	\$16,500, no additional age 50+ contribution allowed Double limit catch-up for Ees within 3 yrs retirement: lesser of \$33,000 (2 x basic annual limit) or basic annual limit + underutilized limit in prior years

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Comparison of New Comparability and Cash Balance Plans					
	Age	Salary	New Comparability	Cash Balance	Percent of Salary
Owner	55	\$225,000	\$49,000	\$153,000	22%,68%
EE1	34	\$34,000	\$1,700	\$5,380	5%,16%
EE2	30	\$30,000	\$1,500	\$4,750	5%,16%
EE3	28	\$28,000	\$1,400	\$4,430	5%,16%
EE4	20	\$20,000	\$1,000	\$3,160	5%,16%
		\$337,000	\$54,600	\$170,720	
Owner's Share of Total			89%	90%	
Two Owners of Different Ages in Cash Balance Plan					
	Age	Salary	Contribution	Percent of Salary	
Owner 1	61	\$225,000	\$150,000	67%	
Owner 2	54	\$225,000	\$150,000	67%	
EE1	48	\$34,000	\$6,075	18%	
EE2	35	\$30,000	\$5,360	18%	
EE3	32	\$28,000	\$5,005	18%	
EE4	26	\$20,000	\$3,575	18%	
		\$562,000	\$320,015		
Owner's Share of Total			93.75%		

Eligible Employee	Age	W-2 Compensation	Traditional Profit Sharing Plan	Age-Weighted	New Comparability
Officer 1	57	\$245,000	\$24,500	\$36,285	\$27,318
Officer 2	48	245,000	24,500	17,412	27,318
Employee 1	50	40,000	4,000	3,347	1,496
Employee 2	35	30,000	3,000	738	1,122
Employee 3	25	20,000	2,000	218	748
Totals		\$580,000	\$58,000	\$58,000	\$58,000
Officer Percent		84%	84%	93%	94%

Available allocation methods in a profit sharing plan using a 10% contribution.

Eligible Employee	Age	W-2 Compensation	Traditional Profit Sharing Plan	Age-Weighted	New Comparability
Officer 1	57	\$245,000	\$49,000	\$49,000	\$49,000
Officer 2	48	245,000	49,000	23,514	49,000
Employee 1	50	40,000	8,000	4,519	2,000
Employee 2	35	30,000	6,000	997	1,500
Employee 3	25	20,000	4,000	294	1,000
Totals		\$580,000	\$116,000	\$78,324	\$102,500
Officer Percent		84%	84%	93%	96%

Available allocation methods in a profit sharing plan maximizing contributions for the oldest owner.