

# Retirement Planning Opportunities

## Money Purchase Plans Are Dead!

### Would a Profit Sharing Plan Be Better for Your Client?

The money purchase plan was popular in the past because it was the only defined contribution plan that allowed your clients to make a tax-deductible contribution of 25% of the plan payroll. For years now you have been able to contribute the same 25% of payroll to a profit sharing plan.

Since profit sharing plans have many advantages over money purchase plans, your clients may want to convert their money purchase plans into profit sharing plans. Let's look at some of the advantages.

### Money Purchase Plans – Inflexible Contributions

Business owners with money purchase plans must contribute exactly the amount required by the plan formula each year. If the plan formula specifies that the contribution is 22.3% of salary, then the business owner must contribute exactly 22.3% of salary each year.

If the business owners contribute too little or too much, then they may have to pay a 10% excise tax on the over contribution or deficiency. This 10% excise tax can be followed by a 100% excise tax if the plan has a deficiency, and this 100% excise tax can be assessed each and every year until the deficiency is made up.

I don't think many of your clients would keep their money purchase plans if they were aware of these penalty taxes.

### Comparison – Money Purchase vs. Profit Sharing/401(k)

Money Purchase Plan	Profit Sharing/401(k) Plan	
\$25,000	\$25,000	25% Pay
0	15,500	Elective Deferral
0	5,000	Catch-Up Contribution
\$25,000	45,500	Totals

\*Figures assume that the business owner is age 52, earning \$100,000 and has no employees. It also assumes the maximum contributions and deferrals allowed in 2008 under the applicable provisions of the Internal Revenue Code. These figures may change in the future since the applicable limits are adjusted for inflation annually.

### Profit Sharing Plans – Flexible Contributions

With profit sharing plans the business owners can contribute any amount between 0 and 25% of the plan payroll each year. They can change the amount they contribute from year-to-year, and they don't even need to have profits to make a contribution. Additionally, there is no penalty excise tax for contributing too little in a profit sharing plan.

### Money Purchase Plans – Maximum Contribution is 25% of Payroll

Deferrals are not allowed in money purchase plans so the total plan contribution is limited to 25% of the plan payroll.

### Profit Sharing Plans - Contribution Can Be Higher Than 25% of Plan Payroll

Profit sharing plans can include a 401(k) element so the total plan contribution can, in some cases, be more than 25% of the plan

payroll. By adding a 401(k) element the employer can sometimes contribute the full 25% of the plan payroll and also let the employees make the maximum deferrals to the plans.

However, the allocations for each participant including the deferrals cannot exceed the lesser of: 100% of the participant's compensation or \$46,000\* (\$51,000\* if the participants are age 50 or older).

### Example of Higher Contributions in Profit Sharing Plans

In our example above, Kim is a businesswoman in her fifties with no employees who is making a salary of \$100,000 each year. In a money purchase plan she is limited to contributing just 25% of her pay or \$25,000.

In a profit sharing /401(k) plan she can contribute that same \$25,000 but also defer \$20,500 for a total contribution of \$45,500. That is almost double the contribution she could make in a money purchase plan.

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## Money Purchase Plans – Severely Limited in Amount of Life Insurance Purchases

In a money purchase plan, life insurance purchases are severely limited by the incidental death benefit rule. This rule specifies that the maximum cumulative premium that can be used to purchase life insurance for any participant must be less than 1/2 of his or her cumulative contributions for whole life insurance and no more than 1/4 of the cumulative contributions for non-whole life policies, like term or universal life insurance.

## Profit Sharing Plans – Very Flexible in Amount of Life Insurance Purchases

Profit sharing plans are also subject to the same incidental death benefit rule, but there are two “aged money” exceptions to this rule that apply only to profit sharing plans and make this rule a lot easier to live with.

The first “aged money” exception allows any participant who has been in the plan for five years to use all of his or her profit sharing account balance to purchase life insurance.

The second “aged money” exception allows a participant to use any profit sharing assets that have been in the plan for two years to purchase life insurance.

Additionally, if your client terminated a money purchase and rolled the assets into the profit sharing plan, 100% of those rollover assets can be used to buy life insurance.

In order for your clients to use either of the two “aged money” exceptions or the rollover money to purchase life insurance, they should make sure

## Comparison – Profit Sharing vs. Money Purchase Which Assets Can Be Used to Purchase Life Insurance

	Profit Sharing Plan	Money Purchase Plan
<b>Incidental Death Benefit</b>	49.99% of Cumulative Contribution if Whole Life Insurance  25% of Cumulative Contribution if Not Whole Life Insurance	The Same
<b>Exception #1</b>	100% of 2 Year Old Assets	Does Not Apply
<b>Exception #2</b>	100% of Account of 5 Year Participant	Does Not Apply

that their plan documents permit this.

Additionally, the two “aged money” exceptions are only available for profit sharing plan money. These exceptions are not available for 401(k) type salary deferrals or matching contributions.

## Money Purchase Plans – Severely Limited in Type of Life Insurance

Participants in money purchase plans cannot purchase survivorship life policies. Additionally, any policies they purchase must be on their own lives.

## Profit Sharing Plans – More Flexibility in Type of Life Insurance

Participants in a profit sharing plan can not only purchase survivorship life insurance, but they can also purchase life insurance on anyone in whom they have an insurable interest. This includes their business partners if they need buy/sell life insurance, their spouses, their children, their grandchildren, their parents, their grandparents, etc.

This means that you may be able to make almost any life insurance purchase that your client wants tax deductible.

## Converting Money Purchase Plans to Profit Sharing Plans

If your clients want to convert their existing money purchase plans into profit sharing plans, the conversion can be as simple as restating their current plan document and re-titling some of the money purchase assets.

Please don't hesitate to contact me if you would like to discuss more of the advantages and disadvantages of money purchase and profit sharing plans. If any of your clients are ready to convert their money purchase plans to profit sharing plans, let me know if they would like help with this transition.

\* Maximum dollar limit allowed in 2008, indexed for inflation and may increase in future