



CPA Quick Guide to Defined Benefit Pension Plans 2021



Qualified Plan Developments

CARES ACT-Sec 201- A new planning opportunity

The CARES Act allows a business owner to adopt a Qualified Plan prior to the date they file their business tax return, including extensions. In the past, the plan would have to formally adopted PRIOR to the close of the business owner's tax year. For example, a business owner with a tax year ending on 12/31 wanting a deduction for 2020, would have had to adopt a plan by 12/31/2020. Now the business owner can adopt a plan for 2020 up to the date they file their 2020 business tax return in the spring or even summer 2021.

SEC 199A – Qualified Business Income Deduction

Effective for 2018, the SEC 199A deduction for qualified business income for pass-through businesses was created by the 2017 Tax Cuts and Jobs Act. Eligible taxpayers may be entitled to a deduction of up to 20% of qualified business income (QBI). Qualification for the deduction is determined by a series of criteria, including the business owner's taxable income and if the business is a "specified service trade or business" (SSTB).

A contribution to a pension plan reduces net taxable income to the business owner, and may allow the business owner to qualify for the QBI deduction. Testing for qualification for the QBI deduction is becoming part of 2018 year-end tax planning for many business owners. Accountants should keep in mind an added pension deduction may facilitate their client's qualifying for the added QBI deduction.

Refer to proposed regulations 1.199A-1 – 1.199A-6, issued August 2018, for details and qualification rules.

New QBI income threshold in 2021- The taxable income threshold amount under Sec 199A(e)(2) to potentially receive the full 20% deduction is \$329,800 for married joint returns, and \$164,900 for single returns.

Later start date for Required Minimum Distributions ("RMD") effective 1/1/2020- RMD starts upon reaching **age 72**. Note for people who reached age seventy and a half by 12/31/2019, they remain under prior rules and RMD starts upon reaching age seventy and a half.

Cost of Living Increases for Qualified Plans: 1-1-2021

The maximum pension benefit, 401K deferral, and eligible pay limits for qualified plans are adjusted each year following the social security benefit adjustment. The following are the increases for the 2019 year:

- 401K deferral limits remain at \$19,500 and if age 50 or over, with an additional \$6,500 catch-up, \$26,000
- A defined benefit pension plan can now provide a maximum annual pension benefit of \$230,000
- Higher compensation that can be considered in calculating benefits. In 2021 the maximum compensation that can be used for plan calculations increased to \$290,000
- Highly Compensated Employee definition – to qualify for 2021, compensation in 2020 must have exceeded \$130,000. To qualify for 2022, compensation in 2021 must exceed \$130,000

1) Defined Benefit Plan Overview (Traditional Defined Benefit and Cash Balance)

- a. Plan Structure – may include 3 elements: The main plan is a Defined Benefit Pension plan. Additional contributions and benefits may include a 401(k) deferral and a profit sharing plan.
- b. The Defined Benefit plan is subject to a required actuarial certification each year and the inclusion of a Schedule B with the annual F-5500 filing with the IRS.
- c. The plan is a qualified plan pursuant to IRC Sec. 401.
- d. Contributions are determined initially and in future years by the actuary taking into account census data provided by the employer, plan asset information, and other IRS actuarial factors.
- e. Employer contributions to the plan are income tax deductible as “ordinary and necessary business expenses” pursuant to IRC Sec. 162.
- f. Employer contributions to the plan are not taxable to a participant (including owner-employees) at the time of contribution.

- g. Benefits are taxable to the participant as ordinary income at the time of distribution (unless rolled over to a successor qualified plan).

2) **Issues Income**

- a. Benefits and resulting plan contributions for business owners are based on earned income subject to an IRC Sec. 415 maximum limit of \$290,000 (2021 limit). Specific definition of eligible compensation depends on the type of business structure.

1) For **S and C-Corps**. Eligible compensation is defined as W-2 income. In most cases, a business owner should take W-2 income of at least \$290,000 to achieve a maximum plan benefit/contribution while maintaining the lowest possible employee cost. If there are no non-owner W-2 employees, the actuary may calculate a lesser W-2 sufficient to meet the business owner's objectives. The pension contribution will be IN ADDITION to the W-2 income taken. For example, if the client wishes to contribute \$255,000 to the pension, his TOTAL income from his business must be at least \$545,000 (\$290,000 of W-2 PLUS the \$255,000 pension contribution equals \$545,000).

2) For **Partnerships**. Partners take K-1 distributions. To be eligible as compensation for a pension plan, K-1 distributions must be subject-to FICA/Social Security taxes ("earned income"). K-1 distributions are in addition to the pension contribution. For example, a partner who desires a \$200,000 plan contribution may need \$290,000 of K-1 income for a total income of at least \$495,000.



3) For Sole Proprietors

- i. "Compensation" on which the owner's benefit/contribution is based is defined as "Net Schedule C earned income reduced by 50% of the Self-Employment tax and further reduced by all employer contributions".
- ii. Note that a pension contribution may NOT create a loss in a Sole Proprietorship. For example, a Sole Proprietor has a plan contribution of \$150,000. They would have to show \$443,243 of total Net Schedule C income to meet plan compensation requirements and have sufficient cash flow to fund the desired plan contribution (\$443,243 Schedule C income after expenses less \$33,243 (7.5%=1/2 Self-employment tax) leaves \$410,000, of which \$260,000 is compensation and \$150,000 is the deductible plan contribution).

3) Accounting for the Plan

- a. **C-corporations** - The plan contribution is taken as a corporate deduction on the corporate tax return, **F-1120, line 23**.
- b. **S-Corporations** - The plan contribution is taken on the S-Corporation tax return, **F-1120-S, line 17**.
- c. **Partnerships** - The deduction for contributions on behalf of **non-partner employees** is taken on the partnership return, **F-1065, line 18**. The deduction for contributions on behalf of partners is reported on the partner's **F-K1, box 13, Code R**, and is taken on the partner's **F-1040, Schedule 1, line 28**.
- d. **Sole Proprietors** - The plan contribution for **participating non-owner employees** is taken on the **Schedule C, line 19**. The deduction for the **owner's contribution** is taken on **F-1040, Schedule 1 line 28**.



F-1040s1 Schedule 1 for Form 1040

Contribution for owners filing as Sole Proprietor (Schedule C) or for partners (K-1)

Adjustments to Income	23	Educator expenses	23			
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 . . .	24			
	25	Health savings account deduction. Attach Form 8889 . .	25			
	26	Moving expenses for members of the Armed Forces. Attach Form 3903	26			
	27	Deductible part of self-employment tax. Attach Schedule SE	27			
	28	Self-employed SEP, SIMPLE, and qualified plans . . .	28			
	29	Self-employed health insurance deduction	29			
	30	Penalty on early withdrawal of savings	30			
	31a	Alimony paid b Recipient's SSN ►	31a			
	32	IRA deduction	32			
	33	Student loan interest deduction	33			
34	Reserved	34				
35	Reserved	35				
36	Add lines 23 through 35				36	

1120 C Corporation Return- Deductions

Employer contribution for shareholder employees and all other participants entered on line 23

12	Compensation of officers (see instructions—attach Form 1125-E)	▶	12		
13	Salaries and wages (less employment credits)		13		
14	Repairs and maintenance		14		
15	Bad debts		15		
16	Rents		16		
17	Taxes and licenses		17		
18	Interest (see instructions)		18		
19	Charitable contributions		19		
20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)		20		
21	Depletion		21		
22	Advertising		22		
23	Pension, profit-sharing, etc., plans		23		
24	Employee benefit programs		24		
25	Reserved for future use		25		
26	Other deductions (attach statement)		26		
27	Total deductions. Add lines 12 through 26	▶	27		
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.			28	
29a	Net operating loss deduction (see instructions)	29a			
b	Special deductions (Schedule C, line 24, column (c))	29b			
c	Add lines 29a and 29b		29c		

In a C-Corporation, the deduction for owner employees is taken at the corporate level.

1120-S S Corporation return- deduction for shareholder employees and all other participants entered on line 17

7	Compensation of officers (see instructions—attach Form 1125-E)	7	
8	Salaries and wages (less employment credits)	8	
9	Repairs and maintenance	9	
10	Bad debts	10	
11	Rents	11	
12	Taxes and licenses	12	
13	Interest (see instructions)	13	
14	Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	14	
15	Depletion (Do not deduct oil and gas depletion.)	15	
16	Advertising	16	
17	Pension, profit-sharing, etc., plans	17	
18	Employee benefit programs	18	
19	Other deductions (attach statement)	19	
20	Total deductions. Add lines 7 through 19	20	
21	Ordinary business income (loss). Subtract line 20 from line 6	21	

F-1065 Partnership return- contribution for non-partner employees line 18

Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9	
	10	Guaranteed payments to partners	10	
	11	Repairs and maintenance	11	
	12	Bad debts	12	
	13	Rent	13	
	14	Taxes and licenses	14	
	15	Interest (see instructions)	15	
	16a	Depreciation (if required, attach Form 4562)	16a	
	b	Less depreciation reported on Form 1125-A and elsewhere on return	16b	
	17	Depletion (Do not deduct oil and gas depletion.)	17	
	18	Retirement plans, etc.	18	
19	Employee benefit programs	19		
20	Other deductions (attach statement)	20		
21	Total deductions. Add the amounts shown in the far right column for lines 9 through 20 .	21		

**Contribution for each partner reflected on the partner's K-1 box 13, code R (below)
And is reported on the Partner's F1040 Schedule 1, Line 28**

		19	Distributions
12	Section 179 deduction		
		20	Other information
13	Other deductions		
R			

Schedule C- Sole Proprietor – contribution for non-owner employees line 19

Part II Expenses. Enter expenses for business use of your home only on line 30.			
8	Advertising	8	
9	Car and truck expenses (see instructions).	9	
10	Commissions and fees	10	
11	Contract labor (see instructions)	11	
12	Depletion	12	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions).	13	
14	Employee benefit programs (other than on line 19).	14	
15	Insurance (other than health)	15	
16	Interest (see instructions):		
a	Mortgage (paid to banks, etc.)	16a	
b	Other	16b	
17	Legal and professional services	17	
18	Office expense (see instructions)	18	
19	Pension and profit-sharing plans	19	
20	Rent or lease (see instructions):		
a	Vehicles, machinery, and equipment	20a	
b	Other business property	20b	
21	Repairs and maintenance	21	
22	Supplies (not included in Part III)	22	
23	Taxes and licenses	23	
24	Travel and meals:		
a	Travel	24a	
b	Deductible meals (see instructions)	24b	
25	Utilities	25	
26	Wages (less employment credits)	26	
27a	Other expenses (from line 48)	27a	
b	Reserved for future use	27b	
28	Total expenses before expenses for business use of home. Add lines 8 through 27a ►	28	

Contribution for the owner reported on F-1040 Schedule 1 – Line 28

4) Time table – Implementation and Administration of the pension plan

a. Implementation

A plan must be adopted with a Trust document executed prior to the filing date of the business owner's tax return under the new CARES ACT provisions.

The TPA/actuaries will:

- 1)** Prepare Plan documents.
- 2)** Letter of Determination requested for all plans.
- 3)** Complete annual compliance testing for all plans including determination of eligibility, calculation of benefits/contributions.
- 4)** Prepare annual Form 5500 for all plans in the program (pension, profit sharing and 401(k)).
- 5)** Annual Actuarial certification Schedule B for defined benefit plans.
- 6)** Annual conference calls to discuss client status:
 - a. Owner's income change?
 - b. Changes in census (new hires? Terminations?)
 - c. Impending changes in the business?

b. Annual Administration

After the close of the business tax year:

- 1.** The actuary will request updated census data from the business owner to determine newly eligible employees, terminations, and to calculate the contribution for all eligible participants.
- 2.** The actuary will request asset valuation from the business owner and /or their advisors.
- 3.** The actuary runs the plan anniversary valuation and provides the contribution amount to the business owner.
- 4.** The business owner makes the balance of their annual plan contribution no later than the date they file their business tax return, including extensions. **Note:** for a calendar year tax payer, the funding deadline is September 15th.

Overview of Plan Types – 2020 Benefit and Contribution Limits

Plan Type: Simple IRA

Maximum Contribution	< Age 50	13,500
	Age 50 +	16,500
	Employee Deferrals	Yes

Employer Contributions for Employees

Options:	Required:	Yes
	Basic:	N/a
	% match	3%
	Non-Elective	2%
	Can exist with other plan(s)	No

Notes: the 3% match is based on total compensation (no compensation limit).
Important note- an employer may not have another qualified plan in the same year
A SIMPLE plan is being funded.

Simplified Employee Pension (SEP)

Maximum Contribution	< Age 50	58,000
	Age 50 +	58,000
	Employee Deferrals	No

Employer Contributions for Employees

Options:	Required:	Yes
	Basic:	% of Pay
	% match	N/a
	Non-Elective	N/a
	Can exist with other plan(s)	Yes

Notes: Maximum 25% of pay, employees same % as owner.
Depending on the SEP plan document sometimes may co-exist with other plans.
Amount available under all plans subject-to added limitations.

Profit Sharing

Maximum Contribution	< Age 50	58,000
	Age 50 +	58,000
	Employee Deferrals	No

Employer Contributions for Employees

Options:	Required:	Yes
	Basic:	% of Pay
	% match	N/a
	Non-Elective	N/a
	Can exist with other plan(s)	Yes

Notes: Employees receive a % of pay, calculated by the actuary/TPA.

Profit Sharing with 401(k)

Maximum Contribution	< Age 50	58,000
	Age 50 +	64,500
Employee Deferrals		Yes

Employer Contributions for Employees

Options:	Required:	Yes
	Basic:	% of Pay
	% match	Yes
	Non-Elective	Yes
Can exist with other plan(s)		Yes

Notes: Employees may receive matching and/or profit sharing contributions calculated by the actuary.

Defined Benefit Pension

2021 Maximum Benefit Limit:	230,000
Can exist with other plan(s):	Yes

Notes: For business owners seeking benefits/contributions that are more substantial than what can be provided by other types of plans.

Contribution determined by the actuary considering desired benefit, age, years to retirement, and current IRS limits and guidelines.

May be combined with a 401(k) Profit Sharing Plan.

Employees receive an employer contribution calculated by the actuary.



Overview of IRC Sections

U.S. Code § 162 - Trade or business expenses

(a) In general

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including:

U.S. Code § 401 - Qualified pension, profit-sharing plans

Defines requirements for qualification

A trust created or organized in the United States and forming part of a pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

- (1)** if contributions are made to the trust by such employer, or employees, or both
- (2)** if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries
- (3)** if the plan of which such trust is a part satisfies the requirements of section 410 (relating to minimum participation standards); and
- (4)** if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees
- (5) Special rules relating to nondiscrimination requirements.**

(A) Salaried or clerical employees. A classification shall not be considered discriminatory within the meaning of paragraph (4) or section 410 (b)(2)(A)(i) merely because it is limited to salaried or clerical employees.

(B) Contributions and benefits may bear uniform relationship to compensation. A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan bear a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees.

(C) Certain disparity permitted. A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan favor highly compensated employees (as defined in section 414 (q)) in the manner permitted under subsection (l).

(6) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards).

(7) A trust forming part of a defined benefit plan shall not constitute a qualified trust under this section unless the plan provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.

(8) Other requirements.

(A) Plans benefiting owner-employees. In the case of any plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(3)), a trust forming part of such plan shall constitute a qualified trust under this section only if the requirements of subsection (d) are also met.

(B) Top-heavy plans.

(i) In general. In the case of any top-heavy plan, a trust forming part of such plan shall constitute a qualified trust under this section only if the requirements of section 416 are met.

(ii) Plans which may become top-heavy. Except to the extent provided in regulations, a trust forming part of a plan (whether or not a top-heavy plan) shall constitute a qualified trust under this section only if such plan contains provisions:

(I) which will take effect if such plan becomes a top-heavy plan, and

(II) which meet the requirements of section 416.

(9) Assignment and alienation.—

(A) In general. A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated

(B) Special rules for domestic relations orders. Subparagraph (A) shall apply to the creation, assignment, or recognition of a right to any benefit payable with respect to a participant pursuant to a domestic relations order, except that subparagraph (A) shall not apply if the order is determined to be a qualified domestic relations order.

(10) Compensation limit.

(A) In general. A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the annual compensation of each employee taken into account under the plan for any year does not exceed \$200,000.

(B) Cost-of-living adjustment. The Secretary shall adjust annually the \$200,000 amount in subparagraph (A) for increases in the cost-of-living at the same time and in the same

manner as adjustments under section 415 (d); except that the base period shall be the calendar quarter beginning July 1, 2001, and any increase which is not a multiple of \$5,000 shall be rounded to the next lowest multiple of \$5,000.

(11) Requirement that actuarial assumptions be specified. A defined benefit plan shall not be treated as providing definitely determinable benefits unless, whenever the amount of any benefit is to be determined on the basis of actuarial assumptions, such assumptions are specified in the plan in a way which precludes employer discretion.

(12) Additional participation requirements.

(A) In general. In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless on each day of the plan year such trust benefits at least the lesser of—

(i) 50 employees of the employer, or

(ii) the greater of—

(I) 40 percent of all employees of the employer, or

(II) 2 employees (or if there is only 1 employee, such employee).

(B) Treatment of excludable employees.

(i) In general. A plan may exclude from consideration under this paragraph employees described in paragraphs (3) and (4)(A) of section 410 (b).

(ii) Separate application for certain excludable employees.— If employees described in section 410 (b)(4)(B) are covered under a plan which meets the requirements of subparagraph **(A)** separately with respect to such employees, such employees may be excluded from consideration in determining whether any plan of the employer meets such requirements if—

(I) the benefits for such employees are provided under the same plan as benefits for other employees,

(II) the benefits provided to such employees are not greater than comparable benefits provided to other employees under the plan, and

(III) no highly compensated employee (within the meaning of section 414 (q)) is included in the group of such employees for more than 1 year.

(C) Special rule for collective bargaining units. Except to the extent provided in regulations, a plan covering only employees described in section 410 (b)(3)(A) may exclude from consideration any employees who are not included in the unit or units in which the covered employees are included.

(13) Determinations as to profit-sharing plans.

(A) Contributions need not be based on profits. The determination of whether the plan under which any contributions are made is a profit-sharing plan shall be made without regard to current or accumulated profits of the employer and without regard to whether the employer is a tax-exempt organization.

(B) Plan must designate type. In the case of a plan which is intended to be a money purchase pension plan or a profit sharing plan, a trust forming part of such plan shall not constitute a qualified trust under this subsection unless the plan designates such intent at such time and in such manner as the Secretary may prescribe.

(14) Benefit limitations. In the case of a defined benefit plan (other than a multiemployer plan) to which the requirements of section 412 apply, the trust of which the plan is a part

shall not constitute a qualified trust under this subsection unless the plan meets the requirements of section 436.

(15) Limitations on elective deferrals. In the case of a trust which is part of a plan under which elective deferrals (within the meaning of section 402 (g)(3)) may be made with respect to any individual during a calendar year, such trust shall not constitute a qualified trust under this subsection unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts, or arrangements of an employer maintaining such plan may not exceed the amount of the limitation in effect under section 402 (g)(1)(A) for taxable years beginning in such calendar year.

(16) Direct transfer of eligible rollover distributions.

(A) In general. A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution—

(i) elects to have such distribution paid directly to an eligible retirement plan, and

(ii) specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe), such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

(17) Distributions during working retirement. A trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under this section solely because the plan provides that a distribution may be made from such trust to an employee who has attained age 62 and who is not separated from employment at the time of such distribution.

(c) Definitions and rules relating to self-employed individuals and owner-employees

For purposes of this section—

(1) Self-employed individual treated as employee

(A) In general

The term “employee” includes, for any taxable year, an individual who is a self-employed individual for such taxable year.

(B) Self-employed individual

The term “self-employed individual” means, with respect to any taxable year, an individual who has earned income (as defined in paragraph (2)) for such taxable year. To the extent provided in regulations prescribed by the Secretary, such term also includes, for any taxable year -

(i) an individual who would be a self-employed individual within the meaning of the preceding sentence but for the fact that the trade or business carried on by such individual did not have net profits for the taxable year, and

(ii) an individual who has been a self-employed individual within the meaning of the preceding sentence for any prior taxable year.

(2) Earned income

(A) In general

The term “earned income” means the net earnings from self-employment (as defined in section 1402 (a)), but such net earnings shall be determined—

(i) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor,
(ii) without regard to paragraphs (4) and (5) of section 1402 (c),
(iii) in the case of any individual who is treated as an employee under sections ^[5] 3121(d)(3)(A), (C), or (D), without regard to paragraph (2) of section 1402 (c),
(iv) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items,
(v) with regard to the deductions allowed by section 404 to the taxpayer, and
(vi) with regard to the deduction allowed to the taxpayer by section 164 (f).

(3) Owner-employee

The term “owner-employee” means an employee who—

(A) owns the entire interest in an unincorporated trade or business, or

(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

To the extent provided in regulations prescribed by the Secretary, such term also means an individual who has been an owner-employee within the meaning of the preceding sentence.

(4) Employer

An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (1).

(5) Contributions on behalf of owner-employees

The term “contribution on behalf of an owner-employee” includes, except as the context otherwise requires, a contribution under a plan—

(A) by the employer for an owner-employee, and

(B) by an owner-employee as an employee.

(6) Contribution limit on owner-employees

A trust forming part of a pension or profit sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the plan provides that contributions on behalf of any owner-employee may be made only with respect to the earned income of such owner-employee which is derived from the trade or business with respect to which such plan is established.

401 (k) Cash or deferred arrangements

(1) General rule

A profit sharing plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified cash or deferred arrangement.

(2) Qualified cash or deferred arrangement

A qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing plan which meets the requirements of subsection (a)—

(A) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;

(B) under which amounts held by the trust which are attributable to employer contributions made pursuant to the employee’s election—

(i) may not be distributable to participants or other beneficiaries earlier than—

(I) severance from employment, death, or disability,
(II) an event described in paragraph (10),
(III) in the case of a profit-sharing plan, the attainment of age 59 1/2,
(IV) in the case of contributions to a profit-sharing plan to which section 402 (e)(3) applies, upon hardship of the employee, or
(V) in the case of a qualified reservist distribution (as defined in section 72 (t)(2)(G)(iii)), the date on which a period referred to in subclause (III) of such section begins, and
(ii) will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years;
(C) which provides that an employee's right to his accrued benefit derived from employer contributions made to the trust pursuant to his election is nonforfeitable, and
(D) which does not require, as a condition of participation in the arrangement, that an employee complete a period of service with the employer (or employers) maintaining the plan extending beyond the period permitted under section 410 (a)(1) (determined without regard to subparagraph (B)(i) thereof).

(3) Application of participation and discrimination standards

(A) A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement unless -

- (i) those employees eligible to benefit under the arrangement satisfy the provisions of section 410 (b)(1), and
- (ii) the actual deferral percentage for eligible highly compensated employees for the plan year bears a relationship to the actual deferral percentage for all other eligible employees for the preceding plan year which meets (prescribed tests)

(4) Other requirements

(A) Benefits (other than matching contributions) must not be contingent on election to defer

A cash or deferred arrangement of any employer shall not be treated as a qualified cash or deferred arrangement if any other benefit is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401 (m)) made by reason of such an election.

(C) Coordination with other plans

Except as provided in section 401 (m), any employer contribution made pursuant to an employee's election under a qualified cash or deferred arrangement shall not be taken into account for purposes of determining whether any other plan meets the requirements of section 401 (a) or 410 (b). This subparagraph shall not apply for purposes of determining whether a plan meets the average benefit requirement of section 410 (b)(2)(A)(ii).

(5) Highly compensated employee

For purposes of this subsection, the term "highly compensated employee" has the meaning given such term by section 414 (q).

(l) Permitted disparity in plan contributions or benefits

(1) In general

The requirements of this subsection are met with respect to a plan if—

(A) in the case of a defined contribution plan, the requirements of paragraph (2) are met, and

(B) in the case of a defined benefit plan, the requirements of paragraph (3) are met.

(2) Defined contribution plan

(A) In general

A defined contribution plan meets the requirements of this paragraph if the excess contribution percentage does not exceed the base contribution percentage by more than the lesser of—

(i) the base contribution percentage, or

(ii) the greater of -

(I) 5.7 percentage points, or

(II) the percentage equal to the portion of the rate of tax under section 3111 (a) (in effect as of the beginning of the year) which is attributable to old-age insurance.

(B) Contribution percentages

For purposes of this paragraph -

(i) Excess contribution percentage. The term “excess contribution percentage” means the percentage of compensation which is contributed by the employer under the plan with respect to that portion of each participant’s compensation in excess of the integration level.

(ii) Base contribution percentage. The term “base contribution percentage” means the percentage of compensation contributed by the employer under the plan with respect to that portion of each participant’s compensation not in excess of the integration level.

(3) Defined benefit plan

A defined benefit plan meets the requirements of this paragraph if -

(A) Excess plans

(i) In general In the case of a plan other than an offset plan -

(I) the excess benefit percentage does not exceed the base benefit percentage by more than the maximum excess allowance,

(II) any optional form of benefit, preretirement benefit, actuarial factor, or other benefit or feature provided with respect to compensation in excess of the integration level is provided with respect to compensation not in excess of such level, and

(III) benefits are based on average annual compensation.

(ii) Benefit percentages For purposes of this subparagraph, the excess and base benefit percentages shall be computed in the same manner as the excess and base contribution percentages under paragraph (2)(B), except that such determination shall be made on the basis of benefits attributable to employer contributions rather than contributions.

(B) Offset plans

In the case of an offset plan, the plan provides that—

(i) a participant’s accrued benefit attributable to employer contributions (within the meaning of section 411 (c)(1)) may not be reduced (by reason of the offset) by more than the maximum offset allowance, and

(ii) benefits are based on average annual compensation.

(D) Offset plan

The term “offset plan” means any plan with respect to which the benefit attributable to employer contributions for each participant is reduced by an amount specified in the plan.

(4) Other definitions and special rules

For purposes of this subsection—

(B) Compensation

The term “compensation” has the meaning given such term by section 414 (s).

(C) Average annual compensation

The term “average annual compensation” means the participant’s highest average annual compensation for -

- (i)** any period of at least 3 consecutive years, or
- (ii)** if shorter, the participant’s full period of service.

(D) Final average compensation

(i) In general. The term “final average compensation” means the participant’s average annual compensation for -

- (I)** the 3-consecutive year period ending with the current year, or
- (II)** if shorter, the participant’s full period of service.

(5) Employees taken into consideration

(A) In general

Any employee who is eligible to make an employee contribution (or, if the employer takes elective contributions into account, elective contributions) or to receive a matching contribution under the plan being tested under paragraph (1) shall be considered an eligible employee for purposes of this subsection.

(B) Limitation on matching contributions

The requirements of this subparagraph are met if -

- (i)** matching contributions on behalf of any employee may not be made with respect to an employee’s contributions or elective deferrals in excess of 6 percent of the employee’s compensation,
- (ii)** the rate of an employer’s matching contribution does not increase as the rate of an employee’s contributions or elective deferrals increase, and
- (iii)** the matching contribution with respect to any highly compensated employee at any rate of an employee contribution or rate of elective deferral is not greater than that with respect to an employee who is not a highly compensated employee.

U.S. Code § 402 - Taxability of beneficiary of employees’ trust

(a) Taxability of beneficiary of exempt trust

Except as otherwise provided in this section, any amount actually distributed to any distributee by any employees’ trust described in section 401 (a) which is exempt from tax under section 501 (a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

Exclusion from income- Rollover

If -

- (A)** any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution,
- (B)** the distributee transfers any portion of the property received in such distribution to an eligible retirement plan, and

(2) Maximum amount which may be rolled over

In the case of any eligible rollover distribution, the maximum amount transferred to which paragraph (1) applies shall not exceed the portion of such distribution which is includible in gross income (determined without regard to paragraph (1)). The preceding sentence shall not apply to such distribution to the extent—

(A) such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust or to an annuity contract described in section 403 (b) and such trust or contract provides for separate accounting for amounts so transferred (and earnings thereon), including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

(B) such portion is transferred to an eligible retirement plan described in clause (i) or (ii) of paragraph (8)(B).

In the case of a transfer described in subparagraph (A) or (B), the amount transferred shall be treated as consisting first of the portion of such distribution that is includible in gross income (determined without regard to paragraph (1)).

(9) Rollover where spouse receives distribution after death of employee

If any distribution attributable to an employee is paid to the spouse of the employee after the employee's death, the preceding provisions of this subsection shall apply to such distribution in the same manner as if the spouse were the employee.

(11) Distributions to inherited individual retirement plan of non-spouse beneficiary

(A) In general

If, with respect to any portion of a distribution from an eligible retirement plan described in paragraph (8)(B)(iii) of a deceased employee, a direct trustee-to-trustee transfer is made to an individual retirement plan described in clause (i) or (ii) of paragraph (8)(B) established for the purposes of receiving the distribution on behalf of an individual who is a designated beneficiary (as defined by section 401(a)(9)(E)) of the employee and who is not the surviving spouse of the employee -

(i) the transfer shall be treated as an eligible rollover distribution,

(ii) the individual retirement plan shall be treated as an inherited individual retirement account or individual retirement annuity (within the meaning of section 408 (d)(3)(C)) for purposes of this title, and

(iii) section 401 (a)(9)(B) (other than clause (iv) thereof) shall apply to such plan.

(B) Certain trusts treated as beneficiaries

For purposes of this paragraph, to the extent provided in rules prescribed by the Secretary, a trust maintained for the benefit of one or more designated beneficiaries shall be treated in the same manner as a designated beneficiary.

(D) Lump-sum distribution

For purposes of this paragraph—

(i) In general The term "lump-sum distribution" means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient—

(I) on account of the employee's death,

(II) after the employee attains age 59½,

(III) on account of the employee's separation from service, or

(IV) after the employee has become disabled (within the meaning of section 72 (m)(7)),

(6) Direct trustee-to-trustee transfers

Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401 (a)(31) shall not be includible in gross income for the taxable year of such transfer.

(f) Written explanation to recipients of distributions eligible for rollover treatment

(1) In general

The plan administrator of any plan shall, within a reasonable period of time before making an eligible rollover distribution, provide a written explanation to the recipient—

(A) of the provisions under which the recipient may have the distribution directly transferred to an eligible retirement plan and that the automatic distribution by direct transfer applies to certain distributions in accordance with section 401 (a)(31)(B),

(B) of the provision which requires the withholding of tax on the distribution if it is not directly transferred to an eligible retirement plan,

(C) of the provisions under which the distribution will not be subject to tax if transferred to an eligible retirement plan within 60 days after the date on which the recipient received the distribution,

(D) if applicable, of the provisions of subsections (d) and (e) of this section, and

(E) of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making such distribution.

(2) Definitions

For purposes of this subsection -

(A) Eligible rollover distribution

The term "eligible rollover distribution" has the same meaning as when used in subsection (c) of this section, paragraph (4) of section 403 (a), subparagraph (A) of section 403 (b)(8), or subparagraph (A) of section 457 (e)(16). Such term shall include any distribution to a designated beneficiary which would be treated as an eligible rollover distribution by reason of subsection (c)(11), or section 403 (a)(4)(B), 403 (b)(8)(B), or 457 (e)(16)(B), if the requirements of subsection (c)(11) were satisfied.

(B) Eligible retirement plan

The term "eligible retirement plan" has the meaning given such term by subsection (c)(8)(B).

(g) Limitation on exclusion for elective deferrals

(1) In general

(A) Limitation

Notwithstanding subsections (e)(3) and (h)(1)(B), the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds the applicable dollar amount. The preceding sentence shall not apply to the portion of such excess as does not exceed the designated Roth contributions of the individual for the taxable year.

(B) Applicable dollar amount

For purposes of subparagraph (A), the applicable dollar amount shall be the amount determined in accordance with the following table:

For taxable years The applicable beginning in dollar amount: calendar year: 2002: \$11,000, 2003: \$12,000, 2004: \$13,000, 2005: \$14,000, 2006 or thereafter \$15,000.

(C) Catch-up contributions

In addition to subparagraph (A), in the case of an eligible participant (as defined in section 414 (v)), gross income shall not include elective deferrals in excess of the applicable dollar amount under subparagraph (B) to the extent that the amount of such elective deferrals does not exceed the applicable dollar amount under section 414 (v)(2)(B)(i) for the taxable year (without regard to the treatment of the elective deferrals by an applicable employer plan under section 414 (v)).

U.S. Code § 410 - Minimum participation standards

(a) Participation

(1) Minimum age and service conditions

(A) General rule

A trust shall not constitute a qualified trust under section 401 (a) if the plan of which it is a part requires, as a condition of participation in the plan, that an employee complete a period of service with the employer or employers maintaining the plan extending beyond the later of the following dates -

(i) the date on which the employee attains the age of 21; or

(ii) the date on which he completes 1 year of service.

(b) Minimum coverage requirements

(1) In general

A trust shall not constitute a qualified trust under section 401 (a) unless such trust is designated by the employer as part of a plan which meets 1 of the following requirements:

(A) The plan benefits at least 70 percent of employees who are not highly compensated employees.

(B) The plan benefits -

(i) a percentage of employees who are not highly compensated employees which is at least 70 percent of

(ii) the percentage of highly compensated employees benefiting under the plan.

(3) Exclusion of certain employees

For purposes of this subsection, there shall be excluded from consideration -

(A) employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers,

(B) in the case of a trust established or maintained pursuant to an agreement which the Secretary of Labor finds to be a collective bargaining agreement between air pilots represented in accordance with title II of the Railway Labor Act and one or more employers, all employees not covered by such agreement, and

(C) employees who are nonresident aliens and who receive no earned income (within the meaning of section 911 (d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861 (a)(3)).

U.S. Code § 411 - Minimum vesting standards

(a) General rule

A trust shall not constitute a qualified trust under section 401 (a) unless the plan of which such trust is a part provides that an employee's right to his normal retirement benefit is non-forfeitable upon the attainment of normal retirement age (as defined in paragraph (8)) and in addition satisfies the requirements of paragraphs (1), (2), and (11) of this subsection and the requirements of subsection (b)(3), and also satisfies, in the case of a defined benefit plan, the requirements of subsection (b)(1) and, in the case of a defined contribution plan, the requirements of subsection (b)(2).

(1) Employee contributions

A plan satisfies the requirements of this paragraph if an employee's rights in his accrued benefit derived from his own contributions are non-forfeitable.

(2) Employer contributions

(A) Defined benefit plans

(i) In general In the case of a defined benefit plan, a plan satisfies the requirements of this paragraph if it satisfies the requirements of clause (ii) or (iii).

(ii) 5-year vesting A plan satisfies the requirements of this clause if an employee who has completed at least 5 years of service has a non-forfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

(iii) 3 to 7 year vesting A plan satisfies the requirements of this clause if an employee has a non-forfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table: The non-forfeitable Years of service percentage is:

3	20	4	40	5	60	6	80	7 or more	100.
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(B) Defined contribution plans

(i) In general. In the case of a defined contribution plan, a plan satisfies the requirements of this paragraph if it satisfies the requirements of clause (ii) or (iii).

(ii) 3-year vesting. A plan satisfies the requirements of this clause if an employee who has completed at least 3 years of service has a non-forfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

(iii) 2 to 6 year vesting. A plan satisfies the requirements of this clause if an employee has a non-forfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table: The non-forfeitable Years of service percentage is:

2	20	3	40	4	60	5	80	6 or more	100.
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U.S. Code § 412 - Minimum funding standards

(a) Requirement to meet minimum funding standard

(1) In general

A plan to which this section applies shall satisfy the minimum funding standard applicable to the plan for any plan year.

(2) Minimum funding standard

For purposes of paragraph (1), a plan shall be treated as satisfying the minimum funding standard for a plan year if—

(A) in the case of a defined benefit plan which is not a multiemployer plan, the employer makes contributions to or under the plan for the plan year which, in the aggregate, are not less than the minimum required contribution determined under section 430 for the plan for the plan year.

U.S. Code § 415 - Limitations on benefits and contribution under qualified plans

(a) General rule

(1) Trusts

A trust which is a part of a pension, or profit sharing plan shall not constitute a qualified trust under section 401 (a) if -

(A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceed the limitation of subsection (b), or

(B) in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitation of subsection (c).

(b) Limitation for defined benefit plans

(1) In general

Benefits with respect to a participant exceed the limitation of this subsection if, when expressed as an annual benefit (within the meaning of paragraph (2)), such annual benefit is greater than the lesser of -

(A) \$220,000, or

(B) 100 percent of the participant's average compensation for his high 3 years.

(2) Annual benefit

(A) In general

For purposes of paragraph (1), the term "annual benefit" means a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions (as defined in sections 402 (c), 403 (a)(4), 403 (b)(8), 408 (d)(3), and 457 (e)(16)) are made.

(B) Adjustment for certain other forms of benefit

If the benefit under the plan is payable in any form other than the form described in subparagraph (A), or if the employees contribute to the plan or make rollover contributions (as defined in sections 402 (c), 403 (a)(4), 403 (b)(8), 408 (d)(3), and 457 (e)(16)), the determinations as to whether the limitation described in paragraph (1) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary by adjusting such benefit so that it is equivalent to the benefit described in subparagraph (A). For purposes of this subparagraph, any ancillary benefit which is not directly related to retirement income benefits shall not be taken into account; and that portion of any joint and survivor annuity which constitutes a qualified joint and survivor annuity (as defined in section 417) shall not be taken into account.

(c) Limitation for defined contribution plans

(1) In general

Contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of—

(A) \$55,000, or

(B) 100 percent of the participant's compensation.

(2) Annual addition

For purposes of paragraph (1), the term "annual addition" means the sum of any year of—

(A) employer contributions,

(B) the employee contributions, and

(C) forfeitures.

(3) Participant's compensation

For purposes of paragraph (1)—

(A) In general

The term "participant's compensation" means the compensation of the participant from the employer for the year.

(B) Special rule for self-employed individuals

In the case of an employee within the meaning of section 401 (c)(1), subparagraph (A) shall be applied by substituting "the participant's earned income (within the meaning of section 401 (c)(2) but determined without regard to any exclusion under section 911)" for "compensation of the participant from the employer".

(d) Cost-of-living adjustments

(1) In general

The Secretary shall adjust annually—

(A) the \$220,000 amount in subsection (b)(1)(A),

(B) in the case of a participant who is separated from service, the amount taken into account under subsection (b)(1)(B), and

(C) the \$55,000 amount in subsection (c)(1)(A),

for increases in the cost-of-living in accordance with regulations prescribed by the Secretary.

U.S. Code § 416 - Special rules for top-heavy plans

a) General rule

A trust shall not constitute a qualified trust under section 401 (a) for any plan year if the plan of which it is a part is a top-heavy plan for such plan year unless such plan meets -

(1) the vesting requirements of subsection (b), and

(2) the minimum benefit requirements of subsection (c).

(b) Vesting requirements

(1) In general

A plan satisfies the requirements of this subsection if it satisfies the requirements of either of the following subparagraphs:

(A) 3-year vesting

A plan satisfies the requirements of this subparagraph if an employee who has completed at least 3 years of service with the employer or employers maintaining the plan has a non-forfeitable right to 100 percent of his accrued benefit derived from employer contributions.

(B) 6-year graded vesting

A plan satisfies the requirements of this subparagraph if an employee has a non-forfeitable right to a percentage of his accrued benefit derived from employer contributions determined under the following table:

The non-forfeitable Years of service percentage is:

2	20%	3	40%	4	60%	5	80%	6 or more	100%
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(c) Plan must provide minimum benefits

(c) Plan must provide minimum benefits

(1) Defined benefit plans

(A) In general

A defined benefit plan meets the requirements of this subsection if the accrued benefit derived from employer contributions of each participant who is a non-key employee, when expressed as an annual retirement benefit, is not less than the applicable percentage of the participant's average compensation for years in the testing period.



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