

## BENEFIT PLANNING, INC.

### Comparison of Profit Sharing Plans to SEP-IRAs Revised March 1, 2005

Employers face several choices when implementing a retirement plan. Many advisors have traditionally looked first at SEP-IRA plans for small business owners. While SEP-IRAs can still be a good fit for some employers, changes in the tax laws from 2001 (EGTRRA) enhanced many qualified retirement plan provisions, and increased the advantages of a qualified plan in many circumstances. Here's our quick take on the pros and cons to consider as you evaluate your options (we indicate in **bold** a significant advantage of one design over the other).

Issue	Qualified Plan	SEP-IRA
Contribution Limits	Up to 25% of eligible compensation, to a maximum of \$42,000. Max comp has been increased to \$210,000 in 2005.	Up to 25% of eligible compensation, to a maximum of \$42,000. Max comp has been increased to \$210,000 in 2005.
Deduction Limits	<b>Up to \$14,000 in 401(k) deferrals are <i>not</i> included in the 25% limit, although they do count against the \$42,000 cap.</b>	Up to \$3,000 in IRA deferrals are <i>not</i> included in the 25% limit.
Allocation Formula	<b>Employer contributions can be varied by age, compensation and integration with Social Security.</b>	Contributions are a set percentage of compensation for all employees
Vesting	<b>Employers can chose between full, gradual, or cliff vesting schedules.</b>	All SEP-IRA contributions are 100% vested immediately.
Government Filings	Qualified plans generally have to file Form 5500s annually with the IRS.	<b>No filings are required.</b>
Eligibility	<b>Can exclude employees working less than 1000 hours per year, at employer's discretion.</b>	Part-time employees must be included.
Loans	<b>Permitted</b>	Prohibited
Annual employer contributions required?	No.	No.
Trustee	<b>Generally self-trusteed</b>	Requires institutional trustee; may require changing legal documents when investment provider is changed

Early withdrawal penalty	<b>Profit-sharing plans can provide for penalty-free distributions at age 55 upon termination of employment. Other distributions are subject to a 10% excise tax if taken before age 59-½.</b>	Distributions taken before age 59-½ are subject to 10% excise tax, with no exception for terminated employees age 55.
Investment Direction	<b>Qualified plans may be either individually directed by the participants, or pooled accounts directed by the trustee.</b>	All SEP-IRAs are individually directed.
Investment Options	<b>Investment in collectibles and purchase of life insurance is permitted.</b>	Neither life insurance nor collectible are allowed.
Top-Heavy Considerations	Qualified plans are subject to top-heavy testing. However, rollover monies are <i>not</i> included in top-heavy calculations.	<b>Most SEP-IRAs are not tested for top-heavy status.</b>
Timing	Qualified plans must be established prior to the end of the plan year.	<b>SEP-IRAs can be established after the end of the plan year, but not later than the tax filing date for the previous calendar year (including extensions).</b>
Catch-up Contributions?	Yes, up to <b>\$4,000</b> for workers age 50 or older in a 401k plan.	Yes, up to \$500 for workers age 50 or older.
Rollovers	Qualified plans can accept rollovers from SEPs, personal IRAs, 403b, 401(k) and other qualified plans.	IRAs can accept rollovers from qualified plans, 403b, 401k and other IRAs.
Bankruptcy Protection	<b>Qualified plans generally provide bankruptcy protection to all participants, including monies transferred from IRAs.</b>	SEP-IRA monies are not protected from creditors.

As you can see, both SEP-IRAs and qualified plans have their strengths and weaknesses; on the whole, SEP-IRAs provide a simpler, less-expensive option for business owners, but at the cost of flexibility, creditor protection and efficiency. With the addition of 401(k) provisions and catch-up contributions, the relative effectiveness of a SEP is reduced, even for an owner-only plan.