401(k) Plans
vs.
ERSOP® Profit Sharing Plans

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Entrepreneurs do not need or want 401(k) plans.

1. ERSOP® or ROBS Plans must be 401(a) Profit Sharing Plans.
2. 401(k) Plans are an optional feature of a Profit Sharing Plan that allows for employee salary deferrals.
3. If an ERSOP® or ROBS Plan contains a 401(k) feature, that feature shall be treated as a separate plan and will have separate requirements.
4. 401(k) features have significant tax and operational disadvantages.
5. When are 401(k)s appropriate?
6. Why do other firms insist on a 401(k)?

1. ERSOP® Plans or ROBS Plans are 401(a) Profit Sharing Plans

The statutory exemption from the prohibited transactions rules require that the "Plan" must be an "eligible individual account plan," which must be a:

i. profit-sharing, stock bonus, thrift, or savings plan;
ii. employee stock ownership plan; or
iii. money purchase plan which was in existence on September 2, 1974.
iv. IRAs are excluded as a "eligible individual account plan."

[Not the IRA money. That money may be rolled over into an "eligible individual account plan" and then used.]

[ERISA section 407(d)(3)(A)]

Neither "401(k)" nor "salary deferral" are included in the above definition.

2. All 401(k) Plans are but Mere Optional Features of Profit Sharing Plans

Internal Revenue Code

Section 401

(k) Cash or deferred arrangements.

(2) Qualified cash or deferred arrangement.

A qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative 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;

3. ERSOP® Plans, ROBS Plans are not 401(k) Plans

ERISA section 407(b)(2)

(A) [An] “eligible individual account plan,” the portion of such plan which consists of applicable elective deferrals [read as 401(k) Plan] (and earnings allocable thereto) shall be treated as a separate plan—

i. which is not an “eligible individual account plan” . . .

4. 401(k) features have significant tax and operational disadvantages.

A. Payroll Tax deductibility of contributions
B. Timing of contributions
C. Contribution Limits
D. Eligibility
E. Vesting
F. Permitted Disparity & Top Heavy
G. Highly Compensated Employees
H. IRS Hates Un-Used 401(k) Plans

A. Tax Deductibility of Contributions

401(k)

- Employee Salary Deferrals subject to F.I.C.A. and Medicare withholding both:

  Employee 7.65%

  and

  Employer 7.65%

  =15.3%

Profit Sharing

- Employer Contributions 100% Deductible.
- No Employee Contributions.

B. Timing of Contribution

401(k)

- Must be deposited by the 7^{th} day after the close of payroll.
- Severe sanctions if not met.

Profit Sharing

- First you must have a profit before you can share it, by definition.
- Contribution must be deposited by the due date of corporate tax return plus extensions in order to be deducted.

C. Deductible Contribution Limits 2014

401(k)

- 100% of salary
- $17,500 limit
- $5,500 catch-up

Profit Sharing

- 25% of salary
- $52,000 limit
- You get fries?

Only Deductible amounts may be contributed.

D. Eligibility

401(k)

- Entry
  - Usually no minimum age
  - Maximum 365 days until entry
  - Cannot be longer than you, should you make an early contribution for yourself.

Profit Sharing

- Entry
  - 21 years old
  - 1 year then beginning-of-year entry dates
  - Last Day of Year Allocation

E. Vesting

401(k)

- Vesting
  - Salary deferrals are always
    - 100%
  - Employer matching contributions used to pass permitted disparity
    - 100%

Profit Sharing

- Vesting
  - Employer Profit Sharing Contributions
    - Year – %

1 –	0
2 –	20
3 –	40
4 –	60
5 –	80
6 –	100

F. Permitted Disparity / Top Heavy

401(k)

- Designed to go Top Heavy immediately when you, the entrepreneur, make your first salary deferral,
- Then
  - 100% vested
  - "safe-harbor" 3% of salary contributions for all others.

ERSOP® Profit Sharing

- Designed not to be top-heavy for the first several years.
- Then
  - class-allocated
  - non-fully vested contributions
  - 1/3 or less of your contribution rate.

G. Highly Compensated Employee

<u>401(k)</u>

- Generally
  - owns 5% or more stock of the employer.
  - Stock owned by the Plan does not count
- Salary
  - $115,000 or more

<u>ERSOP® Profit Sharing</u>

- Generally
  - does not own 5% of the stock of the employer.
  - Stock owned by the Plan does not count
- Salary
  - $115,000 or more

H. The IRS Hates Un-Used 401(k) Plans

From the IRS October 1, 2008 ROBS Memo:

- “A large number of reviewed plans contain . . . a CODA.
- Often, low number of participants actually chose to make salary reduction contributions. . . .
- many of our examiners found this issue and raised it, and usually received a response that the CODA was "inactive." . . .
- There being no such thing as an ”inactive” CODA, . . .”

5. When are 401(k)s appropriate?

- When you need the salary deferral feature to attract a certain kind of employee, generally higher paid.
- When you are buying an existing business which has a existing 401(k) plan and continuity is calming to the employees.
  - Often the pre-existing plan can be maintained intact.

6. Why do other firms insist on a 401(k)?

- If you are a “highly compensated” employee and
- you start salary deferrals [401(k)] contributions right away,
- then the plan goes “top heavy” immediately and
- you have “amended” the plan in practice to include all new employees immediately.
- New employees seldom start salary deferrals immediately so
- you will be making “safe-harbor” 3% of payroll employer matching contributions for all of them in order to pass discrimination testing.
- Salary deferrals must be deposited into the investment accounts within 7 days after the payroll has been paid.
- **Therefore:**
  - **7 days after each and every pay period of yours, whoever sells the investments to the Plan receives a big payday too – they are making a lot of money off you and your Plan – bless their hearts.**