

December, 2011

To My Clients and Friends:

RETIREMENT PLANNING

Current trends in income tax law changes are favoring self-funding mechanisms for retirement plans. In 2002, the tax law took away certain barriers relating to retirement plans for sole proprietorships, partnerships, and S Corporations as they related to their owners, in that they are now on an equal footing with C Corporations.

Retirement plans come in two basic forms: defined benefit and defined contribution. Defined benefit plans are very useful in situations where a sole owner/employee of a business desires to rapidly fund an otherwise under-funded retirement plan. It is not unusual to be able to fund defined benefit contributions of 75% or more of the owner's compensation or earnings. These plans are usually costly to establish and maintain, since an actuary is required to make actuarial calculations for contributions.

Defined contribution plans are generally the most popular because they are less costly to establish and generally easier to administer. Defined contribution plans come in two varieties, money purchase pension plans and profit sharing plans. Prior tax rules usually required the adoption of both a money purchase pension and profit sharing plans to achieve the maximum deduction and flexibility, since money purchase pension plans could be funded at a higher percentage than profit sharing plans. Pension plans can be somewhat burdensome since contributions are almost always required, even in loss years, when funding may not be in the best interest of the Company. The new tax rules took away the funding percentage differential, and now provide that the maximum deduction (25%) can be achieved with the adoption of a profit sharing plan, making the contributions completely discretionary. Therefore, if you have a money purchase pension plan in effect, it most likely should be terminated, and replaced with a profit sharing plan that allows maximum funding permitted by the tax law.

Sole proprietorships and sole owner/employee corporations can now establish 401(k) profit sharing plans, achieving a higher level of funding with a smaller amount of income, all on a discretionary basis with a nominal or no cost for set up, and annual maintenance fees.

With the addition of 401(k) feature to the profit sharing plan and the fact that contributions are discretionary, they are now the plan of choice for sole proprietorships and sole owner/employee corporations.

Further, defined benefit pension plans that have been in existence for some time can be very limited in the amount of funding, meaning that the 401(k) profit sharing may actually yield a higher funding amount.

The following table shows the maximum level of funding possible under the listed assumptions:

	2011 Level of Income			
	<u>\$75,000</u>	<u>\$100,000</u>	<u>\$125,000</u>	<u>\$150,000</u>
Base 401(k) Contribution, Maximum	\$16,500	\$16,500	\$16,500	\$16,500
Catch-up Contribution 50 & over	5,500	5,500	5,500	5,500
Profit Sharing Maximum Percentage (25%)	<u>18,750</u>	<u>25,000</u>	<u>31,250</u>	<u>32,500</u>
Total Contribution allowed	<u>\$40,750</u>	<u>\$47,000</u>	<u>\$53,250</u>	<u>\$54,500</u>

The maximum funding for profit sharing plans for 2011 is \$49,000 plus the \$5,500 catch up contribution if you are 50 & over for a grand total of \$54,500.

If you have a SEP-IRA retirement plan, you should give serious consideration to the establishment of the 401(k) profit sharing plan by December 31, 2011.

Generally, 401(k) contributions can be made on earnings after the plan adoption. That would most likely mean that a 401(k) plan adopted for 2011 may be limited since the 401(k) contribution amount is limited to earnings after adoption. Nevertheless, consideration should be given to adoption of the 401(k) profit sharing plan by December 31, 2011, to be able to realize the maximum contribution deduction in 2011.

I trust that this letter will be useful to you in your tax and financial planning.

If you would like to discuss how the 401(k) profit sharing plan or any other retirement plan can fit into your specific situation, please contact me.

Very truly yours,

Charles E. Solak

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