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Disclaimer

The information and opinions presented today are those of the presenter and do not necessarily represent the opinions or positions of NIPA.

Considerations

- Type of business entity
  - Number of owners
  - Different goals for individual owners.

- Funding flexibility

- Nondiscrimination testing
Types of Unincorporated Entities

- Sole proprietorship –
  - Self-employed, including independent contractors
  - Director’s fees

- Partnership – general, limited, and limited liability (LLP)

- Limited liability company (LLC)

- Owners of such entities are referred to as *self-employed individuals* or *owner-employees*.

Taxation of Unincorporated Entities

- Income or loss of entity flows through to the individual’s personal income tax return (i.e., *pass through entity*)
  - Form 1040, Schedule C for sole proprietors
  - Partnerships file Form 1065 and issue Schedule K-1 to partners

- Deductions, *above the line* and *below the line*
Sole Proprietorship

- Unincorporated business owned by only one person.
- Completes Schedule C (Form 1040) with regard to business income and expenses
- Plan contributions for employees of sole proprietorship are deducted \textit{above the line}
- Sole proprietor’s share of contribution allocation is deducted \textit{below the line}
- Compensation for plan purposes is \textit{earned income}
- Business must establish plan and cover employees

Partnerships

\textbf{Types of Partnerships}

- General
- Limited
- Limited Liability Partnership (LLP)

\textbf{Taxed as:}

- Partnership (default)
- Corporation
Limited Partnership

- Allows a partner’s liability to be limited to equity in the partnership
  - Often used when one partner is the “money guy” and other partner(s) run the day to day business
  - Limited partner’s income is passive income so may not be used as compensation for plan purposes.

Limited Liability Partnership (LLP)

- LLP is a partnership that has registered with the state as an LLP.
  - Must be organized for profit
  - Subject to dissolution on the dissociation of a member (partner)
  - Otherwise, partners treated as general partners
  - LLPs are treated as partnerships for tax purposes, unless it elects to be taxed as corporation.
  - If LLP taxed as partnership, then follow partnership rules (i.e., earned income)
    - If LLP taxed as corporation, then partner must have W-2 compensation
    - LLP must establish plan to cover partners and employees.
Limited Liability Companies (LLC)

- LLC allows for limited liability like a corporation but provides option to operate as a partnership for tax purposes.
  - An LLC with a single owner may elect to be taxed as a sole proprietor
  - A member could be an individual or another entity (e.g., corporation).
  - If LLC taxed as a corporation, then owners (members) must receive W-2 income for plan purposes.

§ 401(k) for Self-Employed/Partners

- Earned income is not treated as currently available until end of the taxable year
  - Taking periodic deferrals from advances or “draws”
  - So-called *guaranteed* payments
S Corporations

• Is a corporation that has elected to be taxed as a partnership
  • Income/loss flows through to shareholder-employees
  • S Corp files Form 1120S

• Plan compensation is W-2 compensation only

• S Corp must establish plan

Traditional C Corporation

• Is a taxable entity
  • Owners recognize no items of income or loss based on the corporate profits/losses.
  • Owners not responsible for liabilities of the corporation.
  • Dividend is not deductible to corporation but is taxable to recipient.

• Only W-2 income may be used for plan compensation.
Compensation Summary

- Common law employees
- C-corporation owners
- S-corporation owners
- Sole Proprietors/Partners
- Members of LLP
- Members of LLC [depends on tax structure]
  - If Partnership, Earned Income
  - If Corporation, W-2

W-2

Earned Income

Deductions / Funding

- Employer contributions to defined contribution plans = 25% of eligible compensation
  - Does not include participant contribution amounts
  - DB / DC combination plans have different limits
- Cash flow
  - How established is business?
  - Make sure prospective client understands funding requirements and timing.
  - Don’t forget to discuss fees!
### Who May Sponsor Plans?

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>Sponsor Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIMPLE IRA</td>
<td>Any business with no more than 100 employees earning at least $5,000 in the preceding year. Must be calendar year plan but may adopt as late as October 1.</td>
</tr>
<tr>
<td>SEP</td>
<td>Any business</td>
</tr>
<tr>
<td>SIMPLE 401(k)</td>
<td>Any business with no more than 100 employees earning at least $5,000 in the preceding year.</td>
</tr>
<tr>
<td>401(k)</td>
<td>Any business; however, note that state/local governmental cannot have a 401(k) unless in effect on 05/06/1986. Native American, rural cooperatives and federal government may have 401(k).</td>
</tr>
<tr>
<td>Profit Sharing / Money Purchase</td>
<td>Any business</td>
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</tbody>
</table>

### Required Contributions

<table>
<thead>
<tr>
<th>Type of Plan</th>
<th>Employees</th>
<th>Plan Sponsor</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIMPLE IRA</td>
<td>Elective deferrals up to $12,500 plus $3,000 catch-up</td>
<td>Either a 100% match up to a maximum of 3% of pay, or a contribution of 2% for each eligible employee. Note: 3% match may be reduced to 1% in 2 out of 5 years.</td>
</tr>
<tr>
<td>SEP</td>
<td>None</td>
<td>Discretionary, but must be uniformly calculated or satisfy integration rules.</td>
</tr>
<tr>
<td>SIMPLE 401(k)</td>
<td>Elective deferrals up to $12,500 plus $3,000 catch-up</td>
<td>Either a 2% of pay contribution to each eligible employee or a 100% match to a maximum of 3% of pay.</td>
</tr>
<tr>
<td>401(k)</td>
<td>Elective deferrals (pre-tax or Roth) up to $18,000 plus $6,000 catch-up</td>
<td>Fixed or discretionary match permitted. Safe harbor requires contributions. 25% of pay limit.</td>
</tr>
<tr>
<td>Profit Sharing / Money Purchase</td>
<td>None</td>
<td>PS – discretionary; MP – required. 25% of pay limit.</td>
</tr>
</tbody>
</table>
SIMPLE IRA Features

- Top-heavy rules do not apply.
- Exempt from nondiscrimination testing of elective deferrals.
- Immediate vesting.
- Withdrawals are permitted at any time; however, not eligible for rollover to eligible retirement plan if individual has less than 2 years of participation in SIMPLE.
- No Form 5500.
- Requires minimal employer cost and administration. No flexibility in employer contribution; must cover all employees of related employers (no § 410(b) carve-outs).

SEP Features

- Top-heavy = up to 3% of gross compensation for all non-key employees.
- Immediate vesting.
- Withdrawals are permitted at any time.
- Generally, no Form 5500 (see ERISA Reg. 2520.104-48/49)
- Plan may be established after employer fiscal year end up to tax filing deadline (e.g., April 15)
- Requires minimal employer cost and administration. May be easy for employer to overlook technical requirements; must cover all employees of related employers.
Simple 401(k) Features

• Top-heavy rules do not apply.
• Exempt from nondiscrimination testing of elective deferrals.
• Immediate vesting.
• Withdrawals limited to hardship, severance from employment, death, disability, age 59½, termination of plan.
• Form 5500 filing required.
• Requires more employer cost and administration. No flexibility in employer contributions.

<table>
<thead>
<tr>
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<th>2016</th>
<th>2015</th>
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<tbody>
<tr>
<td>IRA Contributions Limit</td>
<td>$5,500</td>
<td>$5,500</td>
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<td>IRA Catch-Up Contributions</td>
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<td>IRA AGI Deduction Phase-out Starting at</td>
<td>61,000</td>
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<td>Single or Head of Household</td>
<td>95,000</td>
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<td>SEP Minimum Compensation</td>
<td>600</td>
<td>500</td>
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<td>SEP Maximum Contribution</td>
<td>53,000</td>
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<tr>
<td>SEP Maximum Compensation</td>
<td>265,000</td>
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<tr>
<td>SIMPLE Plans</td>
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<tr>
<td>SIMPLE Maximum Contributions</td>
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<td>Catch-up Contributions</td>
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<tr>
<td>Annual Compensation</td>
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<tr>
<td>Catch-up Contributions</td>
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<tr>
<td>Defined Contribution Limits</td>
<td>53,000</td>
<td>53,000</td>
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What Does the Owner Want?

• Considerations:
  • Stability of owner’s compensation / earned income
  • Desire to maximize owner allocations
  • Other family members working in the business
  • Need plan for recruiting new hires
  • Ability to skip employer contributions on short notice
  • Internal resources for managing plan activity

More than One Owner

• When proposing cross-testing, keep in mind proposed rules published January 29, 2016

• May also help target certain critical employees for additional contributions
Talk about Administration

• The need for complete and accurate census and other data every year.

• Help client understand what they need to do internally to manage proposed plan, especially if plan allows elective deferrals.

• Administration timeline, theirs and yours
  • Don’t forget to discuss any required distribution of notices

Talk About Funding

• Timing of transfer of elective deferrals and other employee amounts to plan

• What happens if money not funded timely….or at all

• Earned income issues
Talk About Fees

• Proposals
• Adoption and implementation costs
• Testing and corrections
• Special designs (e.g., cross-testing)
• Plan changes, amendments and restatements
• Termination

In Conclusion

• Type of plan that best suits a particular business is based on many factors

• Evaluate what internal resources of the business can be devoted to plan operation

• Talk about all of the money – plan contributions and fees/expenses!
Thank You!