

Which Retirement Plan is Right for Your Business?

Today's employees are very aware of the value of retirement benefits. If you currently don't offer a retirement plan or you're not offering the most appropriate one, you may very well be at a disadvantage in the competition to recruit and retain talented employees.

But it doesn't have to be that way.

There are retirement plan options that can address the needs of your business—plans that offer your employees tax advantages yet won't strain your budget or bog you down in paperwork.

The key is to understand your options, and that's where we can help.

THE OPTIONS

There is no single retirement plan that is right for every business. Choosing the best retirement plan or combination of plans for your business means considering many different factors, including:

- The size of your business
- Consistency of earnings
- The degree to which you want your employees to contribute to the plan
- The degree of control you want over employee eligibility
- Your willingness to limit plan flexibility to help maximize tax benefits.

DEFINED CONTRIBUTION PLANS

Your retirement plan can be funded by your company, your employees, or both. The following defined contribution plans use a formula, usually a percentage of an employee's salary, to determine the level of contributions. With these plans, an employee is not promised a fixed pension benefit at retirement. Instead, the benefit is based on the value of contributions in the employee's account plus any investment performance.

Profit-Sharing Plan

This is the most flexible of the defined contribution plans because it permits you to decide how much or how little to contribute each year.

With this plan:

- You can make larger contributions in good years and smaller or no contributions in low profit years.
- Profit-sharing allocations are usually geared to the participant's compensation but may alternatively include a provision to weight the contribution by age. This could permit larger contributions for those closer to retirement age.
- Plan contributions can also be designed to favor highly compensated employees by integrating the plan contributions with Social Security.

Consider this plan if:

- Your business is new and has no profit pattern and/or needs the flexibility of annual contributions that can range from zero to 25% of compensation with compensation of up to \$225,000 (2007, indexed for inflation in \$5,000 increments) taken into account for this purpose. There is also a dollar limit of \$45,000 (2007, indexed¹).
- You want your plan to have a vesting schedule.
- You want the creditor protection of an ERISA plan.

Keep in mind:

- Employer deductions can be as high as 25% of compensation.
- Annual government reporting and disclosure are required.

¹Unless otherwise specified, annual indexing is in \$1,000 increments.

Money Purchase Pension Plan

This type of plan is less flexible than a profit-sharing plan because your company is required to make an annual contribution based on a fixed percentage of each participant's compensation.

With this plan:

- You can contribute as much as 25% of compensation.
- Contributions must be made annually.
- The annual addition to all defined contribution plans of an employer for any employee can be as high as 100% of compensation or \$45,000 (2007, indexed).

Consider this plan if:

- You are willing to be obligated to make annual contributions under a plan formula.
- Your business has a stable cash flow.
- You are able to make the required annual contributions.

Keep in mind:

- You must follow the plan contribution formula and contribute each year.
- Annual government reporting and disclosure are required.
- A profit-sharing plan is often preferable to a money purchase pension plan since it provides you with the same 25% of compensation deduction limitations without committing you to a stated annual contribution.
- If you adopt a money purchase pension plan, the permanency requirements require that it be maintained for a number of years before it is terminated.

Simplified Employee Pension Plan (SEP)

An SEP is a simpler, less expensive alternative to a profit-sharing plan. An SEP generally does not have the annual government filing requirements found with other qualified plans.

With this plan:

- You can contribute annually to each participant's account up to 25% of compensation or \$45,000 (2007, indexed), whichever is less. There is a \$225,000

compensation limit (2007, indexed in \$5,000 increments).

- Contributions need not be made in low profit years.

Consider this plan if:

- Your business is new or has no consistent profit pattern and you need contribution flexibility.
- Cost and simplicity are your main concerns, and you would rather not get involved with vesting schedules, loan provisions, and other options available to other qualified plans.
- You want to avoid substantial annual reporting and disclosure generally required with qualified plans.

Keep in mind:

- Unlike a profit-sharing plan, an SEP must cover all employees age 21 and over who have worked for the business during three of the immediately preceding five years and have earned at least \$500 (in 2007, indexed in \$50 increments) during the year.
- An SEP is funded by the employer through an Individual Retirement Account (IRA) for each employee. This means your employees – not you – have full control over their accounts.
- Contributions are fully vested from day one. There is no vesting schedule.

401(k) Plan

This popular vehicle enables employees to voluntarily contribute up to \$15,500 (2007, indexed in \$500 increments) of their compensation into the plan on a pre-federal income tax basis. Your company can make matching contributions to some or all of what they contribute.

In addition, salary deferrals may be increased by individuals who are age 50 by the end of the plan year up to the lesser of participating compensation for the year or \$5,000 (2007, indexed in \$500 increments). These catch-up contributions are not taken into account when applying other contribution limits. Employers can make matching contributions to catch-ups, but they are subject to normally applicable rules.

With this plan you may offer many options:

- Matching employer contributions
- An employer-paid profit-sharing arrangement
- A vesting schedule on profit-sharing and/or matching contributions
- The ability to exclude certain classes of workers from participating
- Loan and hardship withdrawal provisions.

Consider this plan if:

- You want to give employees the opportunity to contribute toward their own retirement, possibly increased by employer contributions.

Keep in mind:

- Despite their great flexibility, 401(k) plans are subject to annual nondiscrimination testing. (Certain 401(k) plans with “safe harbor” formulas may avoid the Actual Deferral Percentage Test and the Actual Contribution Percentage Test.) The purpose of the nondiscrimination tests is to limit the difference in average contributions between highly compensated participants and all other eligible employees for the preceding year. It is important to get a high level of participation from your lower-paid employees since it helps you to pass the tests and increases your plan’s effectiveness.
- You must be willing to absorb the potential higher administrative expenses compared with other profit-sharing and money purchase pension plans.

Simple IRAs

With a Simple IRA, employees can set aside as much as \$10,500 (2007, indexed for inflation in \$500 increments) in pre-tax income. For individuals who are age 50 by the end of the year, additional catch-up contributions may be made which are limited to \$2,500 in 2007 (indexed for inflation in \$500 increments).

With this plan:

- All contributions are immediately vested.
- Since there are no discrimination tests, the plan is generally easier to administer, which reduces administrative expenses.
- The employer must make matching

contributions for eligible employees who elect to defer salary under the plan or, alternatively, a nonelective contribution for all eligible employees whether or not they elect to defer salary.

Consider this plan if:

- You own a business with 100 or fewer employees.
- You want to offer your staff the opportunity to contribute pre-federal income tax dollars to their retirement plan without the complex administration of a 401(k) plan.
- You can afford a small employer match or nonelective contribution.

Keep in mind:

- Your business is generally required to match contributions of eligible employees dollar-for-dollar up to 3% of compensation (not counting any catch-up contributions) but may contribute as little as 1% in up to two years in any five-year period, or alternatively, to contribute a flat 2% of compensation to all eligible employees whether or not they defer compensation.

DEFINED BENEFIT PLAN

In this type of plan, specific benefits at “normal retirement age” are guaranteed. The employer is required to maintain a minimum funding level based on actuarial calculations to assure that adequate funds will be available to pay the guaranteed retirement benefits. This differs from the previously discussed defined contribution plans, where only the annual contributions are pre-determined, with no promise as to the retirement amounts the plan will ultimately pay out.

With this plan:

- The maximum annual benefit allowed at age 65 is the lesser of the average of an employee’s highest three years of compensation or \$180,000 (2007, indexed in \$5,000 increments). If normal retirement age is earlier than age 62, these maximum limits are reduced.
- Generally, older, more highly compensated employees receive a higher level of tax-deferred retirement savings and income.

Consider this plan if:

- You are an older small business owner, 15 or fewer years away from retirement, with a generally younger staff.
- You are an older business owner who is getting a late start on saving for retirement.

Keep in mind:

- Contributions are required to be made each year by the employer to fund the group's projected benefits. These contributions will fluctuate depending on actual investment performance. Unlike defined contribution plans, there are no maximum contribution limits.
- These plans tend to be more expensive to establish and maintain due to their complexity, the need to pay for an actuary, and the minimum funding requirements.
- Nongovernmental employers who administer defined benefit plans must purchase insurance from the Pension Benefit Guaranty Corporation (PBGC).

NONQUALIFIED DEFERRED COMPENSATION PLANS (NQDC)

Nonqualified strategies are very flexible because, unlike qualified retirement plans, they don't have to meet government-imposed employee coverage or funding rules. Also, reporting and disclosure requirements are generally minimal.

NQDC plans can be designed either like a defined contribution plan, where contributions are determined and the retirement benefit is a result of investment performance, or like a defined benefit plan, where the benefit is determined and contributions vary depending on the investment performance.

With this plan:

- You can provide additional benefits to selected management or highly compensated employees.
- Benefits may include retirement income, survivor benefits and, in some cases, disability benefits.

Consider this plan if:

- You want to single out and reward a select group of more highly paid employees, including yourself.
- You have continuity of management to assure that the business will be there to make retirement payments.

Keep in mind:

- In most cases, the business won't receive a federal income tax deduction on contributions. Instead, tax deductions are received as retirement payments are made to the covered employees.

THE NEXT STEP

We can help explain your options and, along with your professional legal and tax advisors, develop solutions that meet your personal goals and business objectives. We will work with you and your other professional advisors to review or establish your plan and answer your questions. After asking you to fill out a questionnaire to help us understand your employee base and your objectives, we can provide you with a number of alternatives to consider. Once your plan is in place, we will monitor it to make sure it continues to meet your needs. You and your employees deserve the right retirement plan. Take the next step by calling your licensed financial professional today.

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