Section 8
QUALIFIED RETIREMENT AND
EMPLOYEE BENEFIT PLANS

Introduction
Many corporations establish qualified retirement plans to fund future retirement benefits for their employees. Although there are several varieties of these plans, all feature three major tax benefits:

1. The corporation may deduct contributions to the plan on behalf of its employees.
2. Employees are not required to include plan contributions in their taxable compensation income.
3. Neither the corporation nor its employees are required to pay tax on income attributable to plan investments.

Note: When the employees retire, their pension distributions are taxable income. Therefore, the retirement plan contributions and investment income are effectively taxed to the employees when they retire and receive their pensions.

The combination of these benefits provides an attractive tax savings opportunity for both corporations and employees.

Retirement Plans
There are two major categories of qualified retirement plans:

- defined benefit, and
- defined contribution.

Defined Benefit Plan
A defined benefit plan is a traditional pension plan. It provides each employee with a retirement benefit that is defined by a formula that
considers years of service, amount of compensation, etc. The corporation is responsible for funding the benefits and makes deductible contributions to the plan based on actuarial calculations.

**Defined Contribution Plans**

There are two major types of defined contribution plans:

1. Profit sharing: A defined contribution plan is often a profit-sharing plan that permits corporations to make discretionary retirement plan contributions based on the amount of corporate profits. A profit-sharing plan may include a 401(k) plan, which permits employees to make elective contributions to the plan from pretax wages. Unlike a defined benefit plan, a profit-sharing plan does not guarantee employees a defined retirement benefit. Instead, benefits depend on the amount of corporate profits, the profitability of retirement plan investments, the amount of employee compensation, and other factors.

2. Money purchase: A defined contribution plan may also be a money-purchase pension plan. In general, a money-purchase pension plan requires fixed annual contributions based on employee compensation, rather than business profits.

**Tax Treatment of Contributions to Qualified Retirement Plans**

Both defined benefit and defined contribution plans are subject to complex nondiscrimination and reporting requirements. In addition, the tax law limits the amount of deductible contributions to the plan, as follows:

- A corporation’s deduction for contributions to a defined benefit plan is based on actuarial calculations, subject to limitations on maximum benefit accruals per employee. For additional information concerning contributions and benefit accruals for defined benefit plans, see IRS Publication 535, *Business Expenses*, and Publication 560, *Retirement Plans for Small Businesses."

- In general, a corporation’s deduction for contributions to a profit-sharing plan cannot exceed 15% of the compensation paid to plan participants. For 2000, an employee’s compensation in excess of $170,000 is not considered for purposes of this calculation. There are also limitations on the maximum contribution per employee.
For additional information on the contribution and deduction limitations, see IRS Publication 535, *Business Expenses*, and Publication 560, *Retirement Plans for Small Business*.

• In general, a corporation’s deduction for contributions to a money-purchase pension plan cannot exceed 25% of the compensation paid to plan participants. For 2000, an employee’s compensation in excess of $170,000 is not considered for purposes of this calculation. There are also limitations on the maximum contribution per employee. For additional information, see IRS Publication 535, *Business Expenses*, and Publication 560, *Retirement Plans for Small Business*.

A corporation’s deductible contribution to qualified retirement plans is reported on line 24, page 1 of Form 1120, Pension, profit-sharing, etc. plans.

**Simplified Employee Pensions (SEPs)**

A SEP is a tax-advantaged retirement plan that permits corporations to contribute to individual retirement accounts, called SEP-IRAs, for employees. The contributions, which are discretionary, are stated as a percentage of employee compensation. Although the requirements for SEPs differ from those of pension and profit-sharing plans, the tax advantages are comparable.—i.e., the corporation deducts its contributions, the employees are not taxed on the contributions, and the investment income compounds on a tax-deferred basis. In general, the tax treatment of SEP contributions follows the rules for profit-sharing plans, including the applicable percentage limitations. For additional information, see IRS Publication 535, *Business Expenses*, and Publication 560, *Retirement Plans for Small Businesses*.

**SIMPLE Retirement Plans**

The ’96 tax legislation introduced a new retirement savings plan, the Savings Incentive Match Plan for Employees (SIMPLE plan), for tax years beginning after 1996. SIMPLE plans are designed to be just that—retirement plans for “small” employers (maximum of 100 employees) that are easier to administer than traditional qualified pension and profit-sharing plans.

Under a SIMPLE plan, employees may elect to contribute a percentage of their compensation to a special IRA. An employee’s elective contribution
cannot exceed $6,000 per year. In general, the employer either matches each employee’s contribution dollar-for-dollar, up to 3% of the employee’s compensation, or makes nonmatching contributions for all eligible employees totalling 2% of employee compensation. For purposes of the 2% nonmatching contribution for 2000, an employee’s compensation in excess of $170,000 is not considered.

Again, the tax consequences of a SIMPLE plan are similar to those for qualified pension and profit-sharing plans—i.e., the employee is not taxed on the elective salary deferrals or the employer’s contribution, the corporation claims a deduction for contributions to the plan, and the investment income compounds on a tax-deferred basis.

The law also provides for SIMPLE Section 401(k) plans for small employers. These plans feature simplified safe harbor rules for meeting certain nondiscrimination tests for Section 401(k) plans.

For additional information, see Form 5304-SIMPLE, Form 5305-SIMPLE, Publication 535, Business Expenses, and Publication 590, Individual Retirement Arrangements.

**Timing of Contributions**

Both a cash-basis and an accrual-basis corporation have until the due date of their current year tax return to make a deductible contribution to their qualified retirement plans for the current tax year. If a corporation extends the due date for filing Form 1120, it has until the extended due date of the return to make its retirement plan contribution. If the contribution for a tax year is made subsequent to year end, it should be specifically designated for the previous tax year.

**EXAMPLE 1:** Armco Corporation is a calendar year taxpayer. The corporation has until March 15, 2001, the due date of its 2000 Form 1120, to make a deductible retirement plan contribution for 2000. If the contribution is made by March 15, 2001, it is deductible on the corporation’s 2000 return.

If Armco files Form 7004 to extend the due date of its 2000 return, it has until the extended due date, September 15, 2001, to make a deductible retirement plan contribution for 2000.
It makes no difference whether Armco is a cash-basis or an accrual-basis taxpayer; the rules for retirement plan contributions are the same for both.

Many SEPs and all SIMPLE Plans are maintained on a calendar year. If the corporation is a fiscal-year taxpayer for income tax purposes, it is required to make its SEP or SIMPLE plan contribution by the due date of Form 1120, including extensions, for the tax year that includes the end of the calendar year for which the contribution is being made.

**EXAMPLE 2:** White Corporation files its Form 1120 using a March 31 year end. White has a SIMPLE plan that is maintained on a calendar year basis. White’s SIMPLE plan contribution for 2000 must be made by June 15, 2001, the due date of Form 1120 for March 31, 2001, the tax year that includes December 31, 2000, the end of the calendar year for which the SIMPLE plan contribution is being made.

**Using Retirement Plan Specialists**

Qualified retirement plans are an outstanding employee benefit. However, the calculations, limitations and reporting requirements are complex. Many corporations and tax return preparers seek the professional expertise of a retirement plan specialist to ensure that their plans are maintained in accordance with federal requirements. Other corporations elect not to establish such plans because of the complexity.

**Employee Fringe Benefit Programs**

A corporation may provide one or more nontaxable fringe benefits to its employees, including:

- hospitalization and health insurance, including vision and dental;
- accident or disability insurance;
- group-term life insurance (maximum $50,000 per employee);
- dependent care assistance (maximum $5,000 per employee);
- cafeteria plans;
• qualified education assistance (maximum $5,250 per employee); and

• qualified adoption assistance.

Each of these benefits is subject to special definitions, rules, and requirements, as discussed in IRS Publication 15-B, *Employer’s Tax Guide to Fringe Benefits*. A corporation deducts the cost of providing these benefits on line 25, page 1 of Form 1120, Employee benefit programs. The benefits are not included in taxable employee compensation.

A corporation may provide many other nontaxable fringe benefits to its employees, including:

• qualified moving expense reimbursements;

• meals and lodging furnished on the employer’s business premises for the convenience of the employer;

• de minimis fringes—i.e., fringes of minimal value, such as coffee and doughnuts, occasional overtime supper money, and occasional personal use of the office computer or copier;

• working condition fringes—i.e., property or services that would have been deductible by the employee if he or she had personally paid for the item, such as business education, business dues, and use of a company car for business purposes;

• qualified employee discounts—i.e., discounts on employee purchases of goods or services offered to customers in the normal course of the corporation’s business;

• no-additional cost services—i.e., “excess capacity” fringes, such as free flights for airline employees and free lodging for hotel employees; and

• qualified transportation fringes.

Again, these benefits are subject to special rules and requirements, as discussed in Publication 15-B, *Employer’s Tax Guide to Fringe Benefits*. In general, the cost of providing these benefits is deductible by the corporation wherever the expense would normally be deducted—e.g., office expense for coffee and doughnuts and depreciation expense for computers and copiers—and the value of the benefit is nontaxable to employees.
Quiz 1

Qualified Retirement and Employee Benefit Plans

Problem 1.

Mark each statement True or False.

1. A corporation may provide up to $50,000 of group term life insurance to an employee as a nontaxable fringe benefit.
   a. True       b. False

2. If a fringe benefit is nontaxable to an employee, it is nondeductible by his or her corporate employer.
   a. True       b. False

3. If a corporation pays an employee’s medical insurance premium, the premium is included in the employee’s taxable compensation.
   a. True       b. False

4. Dependent care assistance may be provided as a nontaxable employee benefit.
   a. True       b. False

5. There are two major types of qualified retirement plans—defined benefit and defined contribution.
   a. True       b. False

6. A cash-basis corporation must make its deductible retirement plan contribution by year end.
   a. True       b. False

7. A profit-sharing plan permits a corporation to make discretionary retirement plan contributions based on corporate profits.
   a. True       b. False
8. If a corporation extends the due date for filing its Form 1120, it also extends the due date for making its deductible retirement plan contributions.
   a. True  b. False

9. A corporation’s deductible contribution to a profit-sharing plan is usually based on actuarial calculations.
   a. True  b. False

10. As a general rule, a corporation’s deductible contribution to a qualified profit-sharing plan cannot exceed 15% of employee compensation.
   a. True  b. False

11. If a corporation makes a deductible retirement plan contribution on behalf of an employee, the employee is required to include the contribution in his or her taxable compensation income.
   a. True  b. False

12. A 401(k) plan permits employees to make elective contributions to a qualified retirement plan.
   a. True  b. False

13. A corporation must include investment income from qualified retirement plan investments in its taxable income.
   a. True  b. False

14. Qualified retirement plans are subject to complex nondiscrimination and reporting requirements.
   a. True  b. False

15. Qualified retirement plans provide significant tax benefits to both corporations and employees.
   a. True  b. False
**QUIZ 1  Solutions and Explanations**

*Problem 1.*

1. True

2. False
   The cost of many fringe benefits is both nontaxable to the employee and deductible by the corporation.

3. False
   Medical insurance premiums are nontaxable to the employee.

4. True

5. True

6. False
   A cash-basis corporation has until the due date of its return to make a deductible retirement plan contribution.

7. True
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| **9.** | False  
The contribution is usually based on corporate profits. |
| **10.** | True |
| **11.** | False  
Contributions to qualified retirement plans are nontaxable to the employee. |
| **12.** | True |
| **13.** | False  
Investment income from a qualified retirement plan is nontaxable to the corporation. |
| **14.** | True |
| **15.** | True |
QUALIFIED RETIREMENT AND EMPLOYEE BENEFIT PLANS

NOT SHOWN