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What Is a Money Purchase Pension Plan?

A money purchase plan is a type of defined-contribution plan that is similar to a profit-sharing plan, except that the contribution amounts are fixed rather than variable. Thus, employers are required to make annual contributions to each employee's account regardless of the company's profitability for the year. These plans can be used in conjunction with profit-sharing plans to achieve the maximum contribution levels allowed each year.

Employers that set up money purchase plans must declare a set contribution level each year in the plan document, based on employees' salaries. Companies can contribute up to 25% of the total annual compensation of all plan participants, up to 100% of each participant's salary or \$66,000 in 2023 whichever is less.

Employer contributions are tax deferred as long as the amounts are within annual limits. As with other defined-contribution plans, employee funds accumulate tax deferred until withdrawn. It's important to note that employees are not given the option of contributing additional money to their own accounts. However, they are often allowed to choose which investments will be included in their accounts.

It is common for employers to set up vesting schedules that dictate when an employee can claim the funds from his or her plan. When employees are fully vested, they are able to begin taking withdrawals upon reaching age 59½ without incurring a federal tax penalty. Employees may also borrow from their plans before they reach age 59½ if a circumstance occurs that can be identified as a "qualifying event," as defined in the plan document.

Withdrawals are taxed as ordinary income and must begin after the account holder reaches the age of 73 (for individuals who reach age 72 after December 31, 2022). If you attained age 72 in 2022 or earlier, you are already required to take annual RMDs. The RMD age will rise to 75 in 2033. Withdrawals can be

taken as a lump sum or in minimum annual installments based on life expectancy.

If you are a business owner and desire to attract employees from larger corporations that offer a wide range of retirement plans, then a money purchase pension plan may be an option for you. It allows you to contribute high amounts on your employees' behalf while providing you with the added benefit of tax deductions.

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