# What is a Money Purchase Plan?

A Money Purchase Plan, sometimes referred to as a defined contribution pension plan, is one in which a company's contributions are based on a fixed percentage of employee compensation, to be contributed annually. These plans are for businesses of any size, or individuals with self-employment income, earned on either a full time or part-time basis. Benefits paid out are based upon the amount in the participant's account at the time of retirement.

**Limits and Flexibility:** The overall contribution can be no greater than 25% of compensation. An individual can receive no more than the Internal Revenue Code Section 415(a) limit in effect at the end of the plan year, or $57,000 for plan years ending in 2020; Contributions to a Money Purchase Plan must be made every year, regardless of earnings or profits. It is for this reason that many tax-exempt organizations provide retirement benefits to their employees under a Money Purchase Plan. This avoids any confusion of having a "profit sharing" contribution as tax-exempt organizations are not-for-profit, and avoids board approval each year.

**Vesting:** Because a Money Purchase Plan consists solely of employer money, many employers require a participant to remain employed for a period of time before the account balance is 100% vested. Vesting is simply the amount of the account balance that a participant can take with them when the leave service with the employer. Generally, a participant must be 100% vested within six years of employment with partial vesting beginning in the second year. Some employers may vest their participants over a shorter period, and some may exclude service prior to the effective date of the plan or age 18. The forfeitures, or non-vested amounts left after a participant leaves, are used to reduce future employer contributions.

**Payment of Benefits at Retirement:** The ultimate benefit paid to a participant at retirement or upon separation from service is based on the fair market value of the account at the time of distribution. Similar to a Defined Benefit Pension Plan, the normal form of benefit must be paid in the form of an annuity, or a stream of payments for the life expectancy of the participant. A participant may waive the annuity benefit and take the account balance in a lump sum, rolling the funds over into a qualified account or IRA, or taking the full amount as taxable income.

**Payment of Benefits while Employed:** Participants may be permitted to take loans while still employed, as long as they are repaid within five years on a fixed amortization schedule. Unlike 401(k) plans, however, hardship or any other type of in-service distribution is not permitted.

**Investments:** Under a Money Purchase Plan, the assets may be participant directed or trustee directed. Either way, the trustees must take steps to ensure that the investments are made in a prudent manner, and ultimate liability for the investment choices lies with the trustees, unless specific requirements are met. If the accounts balances are participant directed, the same rules of disclosure that apply to 401(k) plans (the Participant 404a-5 Fee Disclosures) would apply to the Money Purchase Plan.