

Maximizing Retirement Plans



December 2018 Presented by Jan Davis

Overview

Types of Retirement Plans

- IRA Type
 - SIMPLE IRA
 - SEP
- Profit Sharing
 - Pro-Rata
 - Integrated/Permitted Disparity
 - Cross-Tested/New Comparability
- 401(k)/403(b)
 - Solo
 - Traditional
 - Roth
 - Safe Harbor
- Defined Benefit
 - Cash Balance

Plan Implementation Dates

- IRA Type -
 - Generally by due date of tax return including extension
- Profit Sharing
 - By end of year in which plan contribution will be deducted (Dec 31st)
- 401(k)/403(b)
 - Before deferrals begin and at least 90 days before year end for safe harbor
- Defined Benefit/Cash Balance
 - By end of year in which plan contribution will be deducted (Dec 31st)

Retirement Plan Rules:

- Tax advantages make it appealing to employers and participants
- Defer income until retirement
- Cannot discriminate in favor of Highly Compensated Employees (generally - 5% owners and those making over \$120,000)
- Testing is based on percentage of compensation
- Must have written plan document
- Generally, money can only come out for death, disability, retirement or termination of employment

Plan Types

Simplified Employee Pension (SEP)

Ideal for clients with:

- No employees
- High turnover
- Don't realize they need a plan until after the end of the year
- Individual receiving outside Director's Fees

SEP pros and cons

Pros

- 3 year eligibility
- Minimal expenses
- 25% deduction
- Can be established after year end

Cons

- Must benefit all employee who earn more than \$500 per year
- 100% vesting
- No loans
- Limited creditor protection
- Employees can access funds

SEP illustration

	Salary	Employer contrib.
Owner	150,000	37,500
Employee A	45,000	11,250
Employee B	30,000	7,500
Employee C	25,000	6,250
Employee D	8,000	2,000
Total	258,000	64,500
% to Owner		58%

SIMPLE IRA

Ideal for clients with:

- Want contributions in excess of deduction limit
- Family business
- Minimum wage employees
- Minimal resources

SIMPLE IRA pros and cons

Pros

- 2 year eligibility
- Minimal expenses
- No deduction limit
- Allows employee deferrals and catch up deferrals
- No testing

Cons

- Must benefit all employee who earn more than \$5000 per year
- Required contribution (100% on first 3% deferrals or 2% PS)
- 100% vesting
- No loans
- Limited creditor protection
- Employees can access funds

SIMPLE IRA illustration

	Salary	Employer contrib.	-OR-	Deferral	Match	Total
Owner	150,000	37,500		12,000	4,500	13,200
Employee A	45,000	11,250		4,000	1,350	5,350
Employee B	30,000	7,500		2,000	900	2,900
Employee C	25,000	6,250				
Employee D	8,000	2,000				
Total	258,000	64,500		18,000	6,750	24,750
% to Owner		58%				53%

Profit Sharing Plan

Ideal for clients with:

- Employers who are looking to share the profits with their employees
- Employers who want a tax deduction
- Owners who are significantly older than employees
- Owners who make over the taxable wage base

Profit Sharing pros and cons

Pros

- Can test with integrated contribution
- Can test with cross-tested contribution
- Contributions are discretionary
- 2 year eligibility
- Vesting schedules

Cons

- Doesn't allow for employee deferrals
- Higher expenses for administration

Profit Sharing illustration

	Salary	Pro-Rata	Integrated	Cross Tested
Owner	150,000	30,000	35,000	40,000
Employee A	45,000	9,000	9,000	9,000
Employee B	30,000	6,000	6,000	6,000
Employee C	25,000	5,000	5,000	5,000
Employee D	8,000	1,600	1,600	1,600
Total	258,000	51,600	56,600	61,600
% to Owner		58%	62%	65%

Traditional 401(k)

Ideal for clients with:

- Employers who do not want to contribute to a plan
- Employers wishing to maximize contributions
- Employers with substantial resources

Traditional 401(k) pros and cons

Pros

- Can exclude certain classes of employees
- Employer contributions are discretionary
- Catch up contributions available
- Last day and year of service available
- Roth contributions
- Vesting schedules
- Maximum creditor protection

Cons

- Testing required
- Higher administration costs
- More administrative work to track and report deferrals

Traditional 401(k) illustration

	Salary	Deferrals	Match	Total
Owner	150,000	12,000	4,500	16,500
Employee A	45,000	2,700	1,350	4,050
Employee B	30,000	1,800	900	2,700
Employee C	25,000	1,500	750	2,250
Employee D	8,000	480	240	720
Total	258,000	18,480	7,740	26,220
% to Owner				63%

Safe Harbor 401(k)

Ideal for clients with:

- Employers with more than 100 employees and lots of minimum wage employees
- Employers with existing top heavy plans
- Employers who have ADP test refunds
- Employers whose demographics do not accommodate cross-testing

Safe Harbor 401(k) pros and cons

Pros

- Same as traditional 401(k)
- Automatic pass for ADP, ACP and top heavy test

Cons

- Same as traditional 401(k)
- Required contribution (match of 100% on the first 3% and 50% on the next 2% or 3% profit sharing/QNEC)
- Employer safe harbor contributions are 100% vested
- Annual notice requirement

Safe Harbor 401(k) QNEC illustration

	Salary	Deferrals	QNEC	Total
Owner	150,000	24,500	4,500	29,000
Employee A	45,000	2,700	1,350	4,050
Employee B	30,000	1,800	900	2,700
Employee C	25,000	1,500	750	2,250
Employee D	8,000	480	240	750
Total	258,000	30,980	7,740	38,720
% to Owner				75%

Safe Harbor 401(k) Match Illustration

	Salary	Deferrals	Match	Total
Owner	150,000	24,500	6,000	30,500
Employee A	45,000	2,700	1,800	4,500
Employee B	30,000	1,800	1,200	3,000
Employee C	25,000	1,500	1,000	2,500
Employee D	8,000	480	320	800
Total	258,000	30,980	10,320	41,300
% to Owner				74%

Safe Harbor 401(k) Triple Stacked Match illustration

	Salary	Deferrals	Match	Fixed match	Disc. Match	Total
Owner	150,000	24,500	6,000	9,000	6,000	45,500
Employee A	45,000	2,700	1,800	2,700	1,800	9,000
Employee B	30,000	1,800	1,200	1,800	1,200	6,000
Employee C	25,000	1,500	1,000	1,500	1,000	5,000
Employee D	8,000	480	320	480	320	1,600
Total	258,000	30,980	10,320	15,480	10,320	67,100
% to Owner						68%

Safe Harbor 401(k) Triple Stacked Match illustration (low participation)

	Salary	Deferrals	Match	Fixed match	Disc. Match	Total
Owner	150,000	24,500	6,000	9,000	6,000	45,500
Employee A	45,000	2,700	1,800	2,700	1,800	9,000
Employee B	30,000	0	0	0	0	0
Employee C	25,000	0	0	0	0	0
Employee D	8,000	0	0	0	0	0
Total	258,000	27,200	7,800	11,700	7,800	54,500
% to Owner						83%

Cross Tested 401(k) plans

Ideal for clients with:

- Employers wishing to maximize contributions
- Employers with substantial resources

Cross tested 401(k) pros and cons

Pros

- Can provide maximum \$55,000-\$61,000 benefit to owner at a cost of 3-5% to employees
- Allows employer to create multiple levels of contributions

Cons

- More administrative costs
- Maximizing owner may maximize another “unworthy” employee or group to minimize cost

Cross Tested 401(k) QNEC illustration

	Salary	Deferrals	Profit Sharing	Total
Owner	150,000	18,000	43,000	61,000
Employee A	45,000	2,700	2,250	4,950
Employee B	30,000	1,800	1,500	3,300
Employee C	25,000	1,500	1,250	2,750
Employee D	8,000	480	400	880
Total	258,000	24,480	48,400	72,880
% to Owner				84%

Cross Tested 401(k) Safe Harbor Match illustration

	Salary	Deferrals	SH Match	Profit Sharing	Total
Owner	150,000	18,000	6,000	35,000	59,000
Employee A	45,000	2,700	1,800	9,000	13,500
Employee B	30,000	1,800	1,200	6,000	9,000
Employee C	25,000	1,500	1,000	5,000	7,500
Employee D	8,000	480	320	1,600	2,400
Total	258,000	24,480	10,320	56,600	91,400
% to Owner					64%

Cash Balance plans

Ideal for clients with:

- Companies seeking high tax deductions
- Substantial resources
- Companies with stable, predictable income
- Participants they want to target for higher contributions
- An owner within 10 years of retirement

Cash Balance pros and cons

Pros

- Contributions may exceed a 401(k) plan by 2-3 times
- Favors older, higher paid employees that are closer to retirement

Cons

- Plan sponsor assumes responsibility for investment losses
- Higher expenses for installation, administration and termination
- Requires an actuary
- Contributions are mandatory
- May be subject to PBGC premiums
- Higher IRS scrutiny

Cash Balance illustration

	Salary	401(k) Plan	Cash Balance	Total
Owner	150,000	61,000	65,000	126,000
Employee A	45,000	3,150	1,125	4,275
Employee B	30,000	2,000	700	2,700
Employee C	25,000	1,500	500	2,000
Employee D	8,000	500	150	650
Total	258,000	68,150	67,475	135,625
% to Owner				93%

Plan Design

Planning Reminders

- Demographics drive a lot of the testing - they must be right for it to work (older owner, younger employees)
- Compensation matters - all non-discrimination tests are comparing contributions based on a percentage of salary (if salary is low, percentage of contribution will be high)
- Including a spouse/child can often help testing and improve results
- Every plan has a different optimal plan design
- Cash balance plans only work when owners are at max and cross tested design works

Plan Design Illustration

	Pro-Rata	Traditional 401(k)	Safe Harbor 401(k)	Cross Tested 401(k)
Owner	30,000	16,500	30,500	61,000
Employee A	9,000	4,050	4,500	4,950
Employee B	6,000	2,700	3,000	3,300
Employee C	5,000	2,250	2,500	2,750
Employee D	1,600	720	800	880
Total	51,600	26,220	41,300	72,880
% to Owner	58%	63%	74%	84%

Compensation Illustration

Pro-Rata Contribution	Salary \$50,000	Salary \$100,000	Salary \$175,000	Salary \$275,000
Owner	10,000	20,000	35,000	55,000
Employee A	9,000	9,000	9,000	9,000
Employee B	6,000	6,000	6,000	6,000
Employee C	5,000	5,000	5,000	5,000
Employee D	1,600	1,600	1,600	1,600
Total	31,600	41,600	56,600	76,600
% to Owner	32%	48%	61%	72%

Owner Age Illustration

Profit Sharing Contribution	Age 40	Age 50	Age 60
Owner	58,000	61,000	61,000
Employee A	13,000	7,200	4,950
Employee B	8,500	4,800	3,300
Employee C	7,200	4,000	2,750
Employee D	2,300	1,280	880
Total	89,000	78,280	72,880
% to Owner	65%	78%	84%

Year End Planning Opportunities

- If a plan is only providing a safe harbor match, we may be able to do another layer of profit sharing contributions on top of that match
- If the plan is providing a 3% safe harbor QNEC, it was designed to give the owners an additional contribution - probably at least another 6% profit sharing
- If the plan is providing a non-safe harbor match, we could compute an additional match or profit sharing
- We can either try to maximize the owner(s) or compute a certain dollar amount

Plan Design Top 10 List

10. Work with a TPA that know what they are doing

9. Understand the client's goals and resources

8. Gateway Test for cross tested plans says that no HCE can have a contribution more than 3 times the lowest allocation, unless everyone gets a 5% contribution

Plan Design Top 10 List

7. Top Heavy plans happen when the key employees account balances are more than 60% of the total account balances

6. ADP and ACP Tests - In a non-safe harbor plan, the HCEs average deferrals can't exceed the NHCE average deferrals

5. A plan sponsor can't deduct a contribution that is more than 25% of all eligible participant's compensation

Plan Design Top 10 List

4. Compensation over \$275,000 cannot be taken into account for any purpose

3. Participants cannot defer more than \$18,500 (in 2018) with a \$6,000 catch up for those 50 and older

2. Participants cannot receive more than \$56,000 in contributions for a plan year

Plan Design Top 10 List

1. You can not discriminate in favor of an HCE - and if you want to give them a higher contribution than everyone else, you've got to pass a test to prove you aren't discriminating

2019 Plan Limits

Plan Limit	Dollar Limit
Compensation	280,000
Annual Additions (401(k) Plan)	56,000
Annual Additions (Cash Balance)	225,000
Deferrals	19,000
Catch Up	6,000
Highly Compensated	125,000
Key Employee (Officer)	180,000
Key Employee (1% owner)	150,000

Retirement Plan Glossary

- ADP - Average Deferral Percentage
- ACP - Average Contribution Percentage
- HCE - Highly Compensated Employee (a 5% owner or compensation over \$120,000)
- NHCE - Non-Highly Compensated Employee
- QNEC - Qualified Non-Elective Contribution
- TPA - Third Party Administrator (me!)

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