



# Popular Retirement Benefits Designs



## Retirement Benefits Designs, LLC

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# 1. Objectives and Incentives for Employers:

## A. Objectives

The most common objectives the employers have when setting up a retirement benefit program are as follows:

- **To maximize the retirement savings for the owners**
- **To retain/provide incentives for valuable employees**
- **To keep the benefits cost to a minimum**
- **To increase the company's tax deductions**



**Through a careful review of the Employer's situation and intentions, an appropriate benefits program could be designed that would be able to meet these objectives.**

## **B. Incentives for Employers to Implement a Retirement Plan:**

The Government offers great incentives to encourage the employers to set up a qualified retirement plan:

- **Annual Contribution Limits per Person**

**For 2019:** The total employee and employer contribution limit is up to the lesser of \$56,000 or 100% of gross eligible compensation limited to \$280,000. For 401(k) plans and 403(b) plans participants of age 50 or older could contribute up to an additional \$6,000 of pre-tax contribution (salary deferral).

**The 401(k) limit is \$19,000 plus catch-up 401(k) of \$6,000 if the employee is of age 50 or older.**

- **Tax Deductions:** All employer contributions up to 25% of gross eligible compensation are tax deductible to the employer. For plans where there is a funding requirement (defined benefit, cash balanced or money purchase plans), the deductible amount could be higher. This limit does not include 401(k) amounts.
- **Retirement Wealth:** Tax-deferred savings and accumulation for retirement. The contributions and investment income in qualified plans are not taxed until paid out.
- **Tax Credit for 3 Years:** The Government allows for a tax credit to smaller companies of up to \$500 for the first 3 years of the plan to reimburse for the start-up costs. This applies for companies with up to 100 employees (IRS Tax Form 8881).
- **Tax Credit for Employees:** Low-income employees receive tax credit/match by the Government for 401(k) contribution they make.

## 2. Popular Defined Contribution Plan Designs (Description):

### 1. Profit Sharing Plans Only (Examples on page 9):

- **Same Percentage of compensation to all eligible employees (same rate):** This is a very expensive allocation. In order for the owners to maximize their contributions to the limit (\$56,000 for 2019), the rest of the eligible employees would have to receive the same rate of contribution.
- **Integrated Formula:** This plan design permits some disparity in favor of Highly Compensated Employees (HCEs). This is a little better than the first one and very common allocation. Still, if not used with 401(k), the owners would have to give the rest of the employees 16.9% profit sharing, in order to maximize his contribution of \$56,000 (in 2019). This is available with prototype plans.
- **New Comparability (cross-tested) allocation (Most Popular):** This design allows for different percentages of profit sharing for each designated group of employees. This allocation has become very popular. The owners can achieve the maximum allocation by providing only up to 5% of contribution to the employees.

### 2. 401(k) Plans Combined with Profit Sharing Feature

- Tested 401(k) with profit sharing allocation
- Safe Harbor 401(k) with profit sharing allocation
  - Safe Harbor Match with profit sharing
  - Safe Harbor Non-elective contributions with profit sharing



# What is a Safe Harbor 401(k) Plan?

**Safe Harbor 401(k) plans are a salary deferral retirement programs that:**

- Allow to maximize the deferral ability of highly compensated employees
- Satisfy non-discrimination testing requirements for benefits and employee inclusion
- Automatically meet top-heavy testing requirements

There are certain requirements, in order for a 401(k) plan to be considered a safe harbor plan.

**Employer Contributions:** Employers can choose between two contribution strategies that meet the safe harbor requirements.

- 1) **Non-Elective Contributions.** These are also called Safe Harbor QNEC. The employer can make a non-elective pro-rata contribution of at least 3% of each eligible participant's annual compensation. This contribution may be made pursuant to a definitive or a contingent notice (Safe Harbor Notice to participants). Such notice must be given to the employees 30 days prior to the beginning of the next plan year to disclose the safe harbor intention of the employer. If the employer chooses not to make the contribution, non-discrimination testing for the 401(k) contributions will apply.
- 2) **Matching Contributions.** There are two matching contribution formulas that satisfy the safe harbor requirements. With the basic match formula the employer matches 100% of the first 3% of compensation deferred (401(k)), plus a 50% match of the next 2% of compensation deferred. With the enhanced match formula the employer chooses to match at any rate that at least equals the basic match formula (e.g. 100% match of the first 4% of compensation deferred). The maximum safe harbor match is 100% on the first 6% of compensation deferred.

Safe harbor 401(k) plans can be combined with a profit sharing feature. If additional employer non-elective contributions (profit sharing) are made, then those contributions are subject to separate testing for coverage and benefits, which is independent of the safe harbor requirements and does not jeopardize the safe harbor 401(k) status of the plan. The profit sharing feature need not be 100% immediately vested.

## What is a New Comparability Profit Sharing Plan?

New comparability profit sharing plans are qualified retirement plans that allow the employer to maximize plan contributions for a specific group of employees. They can be in combination with a 401(k) arrangement or stand-alone plans. Safe harbor 401(k) plans with a new comparability profit sharing are very popular combinations these days.

In order for such a plan to meet the non-discrimination requirements, certain minimum contributions are required for all benefiting employees. Not all employees have to benefit under the plan. There is a minimum coverage of employees required, in order for the IRC non-discrimination coverage test to pass. Some employees, such as non-resident aliens and union employees can be excluded as well.

The profit sharing contributions need not be 100% immediately vested. Some employees could be excluded.

### Establishing Groups

The structure of the groups must be clearly defined in the plan document. There can be as few as two groups (e.g., highly compensated employees and non-highly compensated employees, or owner employees and non-owner employees), or many more groups can be established based on classifications such as service, job title, division, age, etc.

### Good Candidates

Companies with owners and key employees who are older than a significant portion of their employees are good candidates for a new comparability plan. Keep in mind, if the goal is to maximize contributions for certain groups, the employer should be willing to make flexible contributions, which may vary with demographics.

### Annual Contribution Limits

The maximum contribution amount is \$56,000 for 2019. There is a minimum contribution required for the non-highly compensated employees. The required amount is the lesser of: 5% of compensation or 1/3 of the highest percentage allocated to the highly compensated employees. For example, if the highly compensated employees receive an allocation of 20% of compensation, then the minimum required allocation for the non-highly compensated employees would be 5% of eligible compensation. If the highest percentage for the highly paid group is 12%, then only 4% contribution (one third) is required for the non-highly compensated employees.

### 3. Demonstrations of Various Plan Designs:

#### A. Profit Sharing Plan Only (no 401(k) feature):

The table below illustrates three types of profit sharing plans: (1) Pro-rata allocation, (2) Integrated allocation, and (3) New comparability allocation. It shows the cost for the employer if both owners wish to maximize their annual contribution (\$56,000 for 2019). Allocation (3) is the least costly to the employer. Additional cross testing is required. The 2019 compensation limit is \$280,000.

Name	Age	Compensation	(1) Pro-rata PS Allocation (20% for everyone)	(2) Integrated Profit Sharing Allocation	(2) Integrated Profit Sharing %	(3) New Comparability Profit Sharing	(3) Contri- bution Percent
Owner/Key A	51	\$280,000	\$56,000	\$56,000	20%	\$56,000	20%
Owner/Key B	45	\$280,000	\$56,000	\$56,000	20%	\$52,000	20%
Employee C	40	\$48,000	\$9,600	\$8,112	16.9%	\$2,400	5%
Employee D	32	\$40,000	\$8,000	\$6,760	16.9%	\$2,000	5%
Employee E	28	\$30,000	\$6,000	\$5,070	16.9%	\$1,500	5%
Employee F	25	\$25,000	\$5,000	\$4,225	16.9%	\$1,250	5%
<b>Total Profit sharing /SEP Contribution</b>			\$140,600	\$136,197		\$119,150	
<b>Total Cost for Staff</b>			\$28,600	\$24,197		\$7,150	

## B. 401(k) Plan with Safe Harbor Non-Elective and New Comparability Profit Sharing

In order for Key employees to maximize their annual contribution, a 3% Safe Harbor Non-elective contribution is required for each eligible Employee plus an additional profit sharing contribution of up to 2% (1/3 of the highest % for the Key/ Owners (up to 5%). The 3% safe harbor contribution is carved out of the profit sharing amount. 2019 limits are used here:



Name	Age	Eligible Gross Compensation	Employees' 401(k) Salary Deferrals from payroll	Employer Safe Harbor Non-Elective Contribution (3% for each eligible employee)	Employer Profit Sharing Contribution	Total All Contribution	Total Employer Contribution as a % of gross pay
<b>Owner A (maximum)</b>	51	\$280,000	\$25,000	\$8,400	\$28,600	\$61,000	13.21%
<b>Owner B (maximum)</b>	45	\$280,000	\$19,000	\$8,400	\$28,600	\$56,000	13.21%
<b>Employee C</b>	40	\$48,000	\$2,400	\$1,440	\$682	\$4,800	4.42%
<b>Employee D</b>	32	\$40,000	\$0.00	\$1,200	\$568	\$4,000	4.42%
<b>Employee E</b>	28	\$30,000	\$0.00	\$900	\$433	\$3,000	4.42%
<b>Employee F</b>	25	\$25,000	\$0.00	\$750	\$361	\$1,250	4.42%
<b>Total Contributions</b>			\$42,900	\$21,090	\$59,244	\$130,050	
<b>Total Cost for the Staff</b>			\$0.00	\$4,290	\$2,044	\$6,334	

## C. 401(k) Plan with Safe Harbor Match With New Comparability Profit Sharing (Cross-tested)



This design automatically passes non-discrimination testing and top-heavy requirements, and it allows for the key employees to maximize their contributions. The minimum required match is 100% on the first 3% of salary deferred as 401(k) contributions, plus 50% on the next 2% of compensation deferred. The total maximum match is 4%. Only participants who make 401(k) contributions receive the safe harbor match.

Name	Age	Gross Compensation Capped at the IRS limit for 2019	Employee 401(k) Salary Deferrals from payroll	Employer Safe Harbor Match (4% for each who has 401(k))	Employer Profit Sharing Contribution	Total All types of Contributions	Total Employer Contribution %
Owner/Key A	51	\$280,000	\$25,000	\$11,200	\$25,800	\$61,000	13.21%
Owner/Key B	45	\$280,000	\$19,000	\$11,200	\$25,800	\$56,000	13.21%
Employee C	40	\$48,000	\$2,400	\$1,920	\$1,483	\$3,413	7.11%
Employee D	32	\$40,000	\$0.00	\$0.00	\$1,236	\$1,236	3.09%
Employee E	28	\$30,000	\$0.00	\$0.00	\$927	\$927	3.09%
Employee F	25	\$25,000	\$0.00	\$0.00	\$773	\$773	3.09%
<b>Total for All:</b>			\$46,400	\$24,320	\$52,719	\$123,349	
<b>Total Cost for Staff</b>			\$0.00	\$1,920	\$4,419	\$6,339	

## 4. Important Items to Address Prior to Setting Up a Retirement Benefits Program:



Here are some very important items that must be reviewed prior to the plan design as it concerns the discrimination testing requirements, such as employee coverage and benefits, top-heavy and controlled group situations. This would ultimately affect the outcome of the plan design.

### a. Who is the Employer?

- Are there any other companies owned or partnerships?
- Ownership by attribution – family members
- Other companies, offices or colleges the key employees work at
- Are all employees paid from the same company?
- Identify the employees (leased employees, union, etc.)
- Determine if there is a Controlled Group of businesses or Affiliated Service Group

### b. Prior year census and current year projected census –

This is important for the initial projection to determine key employees, top-heavy issues and cost for the employer. Various projections can be then calculated.

c. **What is the Employer's objective:** Is it just for basic 401(k) contributions; employee's rewards; retention; maximizing the benefits for the executives or owners; maximizing tax deductions, etc. What type and how much contributions are intended to be made by the employer each year? The profit sharing is discretionary – could be a different amount each year or none at all.

d. **Are there any other existing plans of the employer or other affiliated companies (such as SEP, Simple IRA, etc.)?** The Employer cannot have another plan if a Simple IRA is maintained during the year.

## About Retirement Benefits Designs, LLC

We are a benefits consulting firm and provide customized plan designs and third-party administration (TPA) services for retirement benefits plans. We have over 30 years of extensive experience in the retirement benefits industry and provide personal hands-on service to our clients. We have a pro-active approach with our clients and are committed to provide excellent services and consulting.

Our services include: drafting new plan documents and restating existing ones when required; review current plan design and advising on improvements; preparation of contribution projections, non-discrimination testing, annual plan reconciliation and Forms 5500. We educate and keep our clients in compliance with any Government requirements.

**We offer plan reviews, consulting and contribution designs at no charge for our new clients and prospects.**

For more information about us and our services please visit our website.

**If you have any questions, please feel free to contact us.**

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