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Plan Design

We often think of our Third Party Administrator's primary responsibility as compliance with Department of Labor and Internal Revenue Service regulations. All of those compliance issues begin with how your qualified Profit Sharing Plan is originally designed and, as time goes on, how it is modified and amended.

As a business owner working with your Advisor, your Profit Sharing Plan design can also be the biggest opportunity you have to maximize your own pre-tax retirement plan savings. It is also the biggest pre-tax retirement savings opportunity that you can offer your employees. This single "tax leverage" structure is considered by many to be the top chance that the IRS offers to reduce taxable income and fund long-term investment and savings goals like retirement.

Your Advisor will work with you and your other advisors to understand the new "comparability" or "cross tested" plan design options that may provide you as owners or consultants a means to maximize personal contributions while minimizing funding costs. This design structure may also permit a "tiered" plan to target rewards to key employees. Both the tax deduction and the tax deferral of the plan are powerful investment and compounding tools. We can work with your TPA to use this strategy to structure your plan in a manner to help pass the required non-discrimination tests each year. To learn more about one of the TPA professionals we have found to be truly outstanding, visit: www.charteroakpension.com. Of course we are a bit biased as one of Charter Oak's founders is one of ours.

"New Comparability" or "Cross Tested" Profit Sharing Plans have been gaining traction in the marketplace. These plans are primarily tax-qualified defined contribution plans (i.e., Profit Sharing Plans) designed to allow business owners the ability to receive the maximum contribution while minimizing the funding costs for employees. These plans provide a significant advantage to owners and/or highly compensated employees (HCEs) when Owners/HCEs have a higher average age than non-highly compensated employees (NHCEs). Plans can be designed to favor key groups of employees (i.e., owners, key employees, technicians, toolmakers, etc.) and your employer contributions can be "tiered" to target excess contributions to the kinds of favored groups that you want to reward and allows you to minimize contributions for other groups.

Your employer contributions are discretionary allowing you to increase or decrease contributions annually. As a tax-qualified plan, all of your contributions are tax deductible to the business up to a maximum deduction limit of 25% of total eligible payroll. All of the investment gains and interest or dividend income accumulates on a tax-deferred basis.

These Plans may also be combined with a 401(k) salary deferral feature. This allows age 50+ participants to take advantage of the increased contribution limits allowed under the "catch-up" contributions provisions for retirement plans. For 2009, the 401(k) salary deferral limit is $16,500, and the additional catch-up contribution limit is $5,500.

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New Comparability plans have been approved by the IRS as an appropriate plan design. All "New Comparability" Profit Sharing Plans must pass certain non-discrimination tests each year.

Here is a hypothetical comparison of a "New Comparability" or "Cross Tested" Profit Sharing Plan with both the traditional "Normal Allocation Method" and an "Integrated Allocation Method". This illustration uses a payroll/compensation structure that is typical of many small businesses.

Participant	status	AA	Projected Wages	Normal Allocation Method	% of Wage	Integrated Allocation Method	% of Wage	Cross Tested Allocation Method	% of Wage
Owner Employee	**HCE**	**56**	**225,000.00**	**26,877.09**	**11.9%**	**28,368.01**	**13.7%**	**45,000.00**	**20.0%**
Employee	nhce	30	36,452.73	4,354.42	11.9%	3,727.03	10.4%	1,822.64	5.0%
Employee	nhce	27	30,320.54	3,621.90	11.9%	3,100.06	10.4%	1,516.03	5.0%
Employee	nhce	31	62,000.00	7,406.13	11.9%	6,339.06	10.4%	3,100.00	5.0%
Employee	nhce	21	21,675.38	2,589.21	11.9%	2,216.15	10.4%	1,083.77	5.0%
Employee	nhce	31	34,624.56	4,136.03	11.9%	3,540.12	10.4%	1,731.23	5.0%
Employee	nhce	36	37,034.58	4,423.92	11.9%	3,786.52	10.4%	1,851.73	5.0%
Employee	nhce	23	19,173.41	2,290.34	11.9%	1,960.35	10.4%	958.67	5.0%
Employee	nhce	59	19,653.91	2,347.73	11.9%	2,009.47	10.4%	982.70	5.0%
Totals			**485,935.11**	**58,046.77**		**58,046.77**		**58,046.77**	
Percentage to Owner Employee:				**46.30%**		**53.03%**		**77.52%**	

Hypothetical example used for illustrative purposes only. Actual results will vary.

You can see that in the "Normal" Allocation Method the owner receives 46.3% of total plan contributions and in the "Integrated" Allocation Method the owner receives 53.03% of total plan contributions. After using the "New Comparability" or "Cross Tested" Profit Sharing Allocation method the owner receives 77.52% of total plan contributions.

Here is another illustration of a Safe-Harbor 401(k) Plan that has a "Stacked Match" design.

One benefit of this design is that it is exempt from ADP, ACP, and Top-Heavy tests. There are mandatory employer contributions with this plan design. These are calculated as either using:

- A "Matching Contribution" formula equal to dollar-for-dollar of the first 3% of salary deferral contributions and then $0.50 on-the-dollar of the next 2% of salary deferral contributions. Or,
- A "Non-Elective Contribution" equal to 3% of each eligible employee's compensation.

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With a Stacked Match 401(k) Safe Harbor Plan you can use a combination of Safe-Harbor Matching, Fixed Matching, and Discretionary Matching to maximize the percentage of total employer contributions allocated to Highly-Compensated employees (HCEs).

In this illustration we have made certain assumptions: “Non Highly-Compensated Employees” (NHCEs) contribute 5% as a 401(k) contribution. The “Safe-Harbor Matching” formula of 100% of the first 3% deferred, 50% of the next 2% deferred is then used. To this is added a “Fixed Matching” Formula of 85.19% up to 6% deferred and then a “Discretionary Matching” Formula of 66.67% up to 6% deferred is also added:

Participant	Wages	401(k)	Safe-Harbor Matching	Fixed Matching	Discretionary Matching	Total Contributions	Total Employer Cost
HCE1	$225,000.00	$15,500.00	$9,000.00	$11,500.00	$9,000.00	$45,000.00	$45,000.00
HCE2	225,000.00	15,500.00	9,000.00	11,500.00	9,000.00	45,000.00	45,000.00
NHCE1	60,000.00	3,000.00	2,400.00	2,555.70	2,000.10	9,955.80	6,955.80
NHCE2	28,000.00	1,400.00	1,120.00	1,192.66	933.80	4,646.46	3,246.46
NHCE3	35,000.00	1,750.00	1,400.00	1,490.83	1,166.73	4,866.06	4,057.56
Totals	$573,000.00	$37,150.00	$22,920.00	$28,239.19	$22,100.53	$109,468.32	$104,259.82

Hypothetical example used for illustrative purposes only. Actual results will vary.

The results are remarkable. The HCEs are receiving 86.3% of every dollar contributed to the plan ($90,000 of $104,260). This percentage or proportion would increase if NHCEs defer less than 5%. In this illustration it is important to remember that all of the “Safe Harbor Matching” contributions are vested immediately. The additional “Matching Contributions” may be subject to a vesting schedule.