# How Retirement Plan Sponsors Can Take Their Contributions to The Limit

## By Ary Rosenbaum, Esq.

George Carlin once said that the whole meaning of life is not dying, unfortunately, my favorite comedian died from a bad heart. As an ERISA attorney, I believe that the whole purpose of an employer starting and maintaining a retirement plan is saving for retirement and the more money an employer can put away for their employees is less money for the government to get their hands on. Through careful plan design, an employer can maximize contributions to their highly compensated employees while offering a benefit to their lower paid staff. Poor plan design can be costly to the employer through unnecessary contributions, taxable refunds to highly compensated employees, or inefficient use of plan features. So that's why it's important to employers to find third party administrators (TPAs) and ERISA attorneys (cough, cough) to help them navigate through the many different types of retirement plans and plan features. This article is about how plan sponsors can take employer contributions to the limit that puts more money in the pockets of their highly compensated employees and less money in the pockets of government.

**Plain Vanilla 401(k)s and small plans are OK for some**

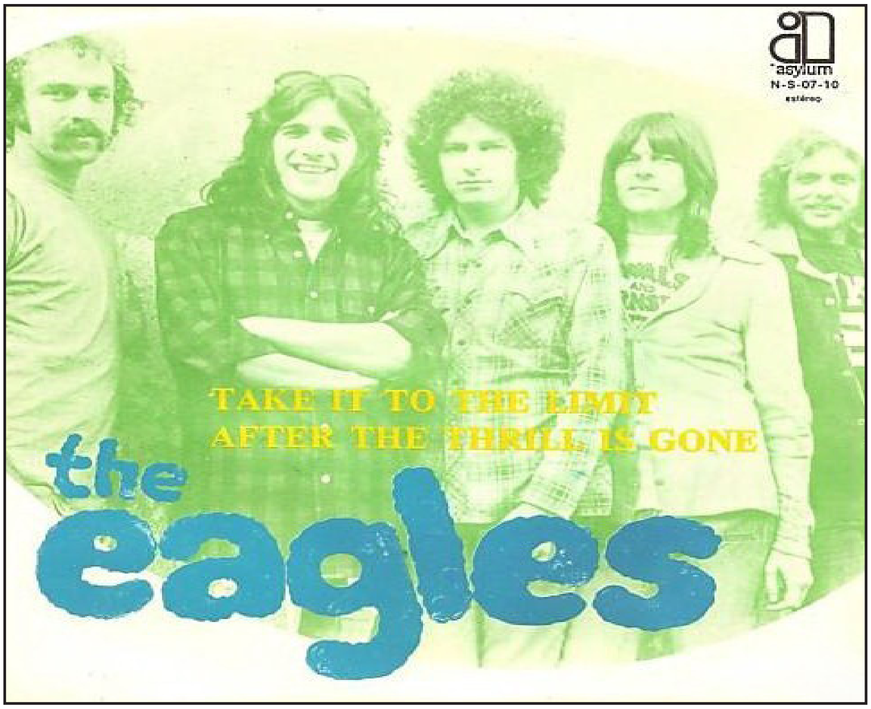
Many small business opt for smaller retirement plans that require no administration and no Form 5500 The tradeoff for using a SEP, a SIMPLE-IRA, or Simple 401(k) is that all contributions must be uniform, meaning a contribution equal to the same percentage of compensation to all employees. So the successful business owner who wants to save $40,000 through his or her SEP will have to make the same generous contribution (percentage wise) to their employees. Business owners want to be generous, but not that generous. Many 401(k) plans offered by payroll companies and other TPAs typically offer that same pro-rata contribution formula whether it's the best fit for the employer or not. Employer contribution formulas can benefit highly compensated employees at a better percentage rate than the rank and files employees, but a pro-rata contribution formula will never give plan sponsors that leeway.

**Integrated and Age Weighted**

There are a number of employer contributions that have been around for quite some time that do offer some variance in employer contributions that can benefit highly compensated employees that the plain vanilla plans don't offer. There is an integrated contribution that gives greater contributions to employees who earn more that the Social Security Wage Base (which is the maximum income when employees stop paying their Social Security tax), Age weighted allocation looks at an employee's age and salary where participants are allocated points and get a pro-rata share contribution based on their points (which is awarded based on age and compensation) to the total points of all participants. The allocation is actuarially calculated. These allocations offer some leeway, but not if you want to reward some employees more than others.

**New Comparability/Cross Tested Allocation**

For the most flexibility of allocating contributions, there is a new comparability allocation that is also called cross-tested. Employers can divide their company into groups of employees or make each employee their own group. By dividing the employee roster into different groups, the employer has flexible latitude in rewarding some employees over others. The employer can make much larger contributions to certain employees as long as they allocate a contribution to non-highly compensated employees (non-5% owners making less than $115,000) called a minimum gateway, which typically will be the lesser of 1/3rd the percentage amount paid to the group who got the highest contribution percentage (as it relates to pay) or 5% of pay. Of course, all these allocations are subject to testing. The beauty of new comparability is that unlike pension plans that




require minimum contributions each year, the new comparability allocation is totally discretionary.

**Safe Harbor 401(k)**

All retirement plans must pass Internal Revenue Code mandated compliance testing to make sure plan provisions don't discriminate in favor of highly compensated employees. One test is the Actual Deferral Percentage (ADP) test that looks at how much employees defer into their 401(k) plan. A plan will fail the ADP test just if the deferral rate of highly compensated employees is more than two percentage points than non-highly compensated employees, so the test is easy to fail. For matching contributions under a 401(k) plan, there is a similar test called the Actual Contribution Percentage Test. If a plan fails either or both tests, the plan must make a corrective contribution or have refunds made to highly compensated employees for deferrals and forfeiting excess matching contributions. A plan sponsor can avoid the testing and allow for highly compensated employees to make the maximum salary deferral and get their full matching contribution by opting to be a safe harbor plan. In order to be a safe harbor plan, the employer must make a fully vested contribution that could be a profit sharing contribution of 3% of compensation or a matching contribution that eventually equals up to 4% of compensation. While the safe harbor profit sharing contribution may be more expensive than the matching contribution, the extra beauty of the profit sharing contribution is that the amount can also serve as the minimum gateway for the new comparability contribution discussed above. While still subject to testing, a plan that uses new comparability with the safe harbor profit sharing contribution can offer their non-highly compensated employees 3% of compensation while the higher paid employees get 9% while allowing the higher paid folks make their full $17,500 salary deferral (in 2013). Making a fully vested, mandatory contribution may be burdensome for some, but for the employers that can do it and need to do it if they would fail the ADP test, it's the best of many worlds.

**Automatic Enrollment**

If an employer can't afford a safe harbor plan, one way to boost the deferrals of highly compensated employees is by improving the deferral rate of non-highly compensated employees. Automatic enrollment allows an employer to automatically deduct elective deferrals from an employee's wages unless the employee makes an election not to defer or to defer a different amount. In addition there is a safe harbor automatic contribution design called a Qualified Automatic Contribution Arrangement (QACA) that offers a maximum matching contribution of 3.5% of compensation and fully vests after 2 years.

**Defined Benefit Plans**

Many folks thought that defined benefit pension plan went out with bell-bottoms and Betamax. Unlike bell-bottoms and Betamax, defined benefit plans are still around for the employers on their own. While these plans require minimum funding and have huge financial commitments, they can be extremely effective in putting away contributions for the highly compensated employees. Defined benefit plans can also be used under a floor-offset arrangement where any required contributions to the non-highly compensated employees may be offset by contributions to a 401(k) plan.

**DB(k) Plan**

Created by the Pension Protection Act of 2006, the DB(k) is a single plan that combines two plan designs: a traditional pension plan with a guaranteed lifetime payment providing an employee benefits equal to 1% of his or her final average compensation per year of service, up to 20 years, and vesting after three years; and automatic enrollment in a 401(k) plan that defers 4% of a participant's salary, with a 50% employer match on that, plus immediate vesting. While the plan is essentially hot off the press, it might be something to look at.

**Cash Balance Plan**

A cash balance plan is a defined benefit retirement plan that maintains hypothetical individual employee accounts like a defined contribution plan. The employees' accounts earn a fixed rate of return that can change over a period of time from year to year. They typically are more flexible than the old defined benefit plan with less demand of required contributions and are integrated well with a safe harbor 401(k). Many professional service firms like law firms have found the cash balance plan in tandem with a safe harbor 401(k) plan as a great fit.

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