

SAFE-HARBOR LEVERAGING FOR SMALL BUSINESS, TOP-HEAVY RETIREMENT PLANS

Updated January, 2008

Many employers are debating how to most efficiently take advantage of the defined contribution limit increase to \$46,000. However, few owners of small businesses are aware of the extent to which certain types of “leveraging” are now permitted in qualified retirement plans. The purpose of this article is to illustrate the provisions that allow owners of small businesses to get the most in return for what they are willing to contribute on behalf of their non-owner employees.

In this article the word “leveraging” pertains to the ways a company can contribute a certain percent of pay for its non-owner employees, while allowing the owner to have a tax deduction of some higher percent of pay. The words “safe-harbor” pertain to the fact that these provisions can be used with automatic pre-approval from the federal government, and no concern for participants’ ages or other facts and circumstances. Also, safe-harbor plans can usually be adopted with lower fees for legal documents.

The qualified plans sponsored by small businesses are usually “top-heavy.” A plan is deemed top-heavy when over 60% of the assets are attributed to officers and shareholders. In such a case, the employer must allocate to each “non-key” employee / participant at least 3% of pay in order to contribute anything significant for the owners. This article is intended to explain the areas of leveraging that we typically recommend in top-heavy plans, as well as the results that can be obtained. Many of these provisions will even be of interest to sponsors of plans not required to make a top-heavy minimum contribution. The following are examples of leveraging allowed in qualified retirement plans, including two rules that have only been effect for the last few years:

A) Permitted Disparity (formerly called “integration with Social Security”) --- Every employer already sponsors one retirement plan called Social Security. However, when viewed as a percent of pay, both the FICA taxes paid by the company and the ultimate Social Security benefits discriminate against higher paid employees. For example, the company must pay the full 7.65% FICA tax for an employee making less than the Social Security taxable wage base (\$102,000 for 2008). But for an owner making twice the taxable wage base, the company’s FICA taxes paid on his behalf come to a much lower percent of his *total* pay. A private industry retirement plan is allowed to make up for this discrepancy by giving the higher paid participants a contribution which is a higher percent of their pay than is given to the lower paid employees. Many times, this permits the owner to get a contribution that is about 3% more than the percent he spends on lower paid participants in the same plan.

B) Safe-Harbor 401(k) Plans --- If an employer is willing to fully vest its top-heavy minimum 3% contribution in a top-heavy plan, then not only does the owner get that same 3% contribution, but he can defer an additional \$15,500 for 2008. This is permitted even if none of the other employees choose to utilize the 401(k) portion of the plan. Also, anyone over age 50 can defer an additional \$5,000 for the year 2008.

C) Matching Contributions --- Even without safe-harbor provisions, 401(k) plans are permitted, within limits, to have owners averaging a higher percent of pay matching contribution than the non-owners receive. With the safe-harbor provision described in the previous paragraph, a plan can have a discretionary match of up to 2/3 of the first 6% of pay contributed by the participant. This results in the owner getting a contribution of another 4% of pay, even if none of the other participants are contributing to the plan.

D) Vesting Schedules --- Much of the company contribution can usually be made subject to a vesting schedule, usually resulting in an even higher portion of the long-term contribution going to the owners.

The attached Tables illustrate what can be achieved by combining some or all of these leveraging rules. RMS can help employers choose the plan design that most efficiently achieves these results.

Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans

Table 1

What % of Pay is the Employer Willing to Contribute for the Lower Paid Employees?	What % of Pay is Expected to be Contributed by the Lower Paid Employees?	OWNER'S ANNUAL PAY												
		\$110,000	\$120,000	\$130,000	\$140,000	\$150,000	\$160,000	\$170,000	\$180,000	\$190,000	\$200,000	\$210,000	\$220,000	\$230,000
		CONTRIBUTION PERCENT THAT CAN BE ACHIEVED FOR THE OWNER												
3%	0%	21%	20%	19%	18%	17%	17%	16%	16%	15%	15%	14%	14%	14%
	2%	17%	16%	15%	14%	13%	13%	12%	12%	11%	11%	10%	10%	10%
	4%	17%	16%	15%	14%	13%	13%	12%	12%	11%	11%	10%	10%	10%
	6%	17%	16%	15%	14%	13%	13%	12%	12%	11%	11%	10%	10%	10%
4%	0%	23%	21%	20%	20%	19%	18%	18%	17%	17%	16%	16%	16%	15%
	2%	20%	19%	18%	17%	16%	16%	15%	15%	14%	14%	13%	13%	13%
	4%	19%	17%	16%	16%	15%	14%	14%	13%	13%	12%	12%	12%	11%
	6%	19%	17%	16%	16%	15%	14%	14%	13%	13%	12%	12%	12%	11%
5%	0%	24%	23%	22%	21%	20%	20%	19%	19%	18%	18%	18%	17%	17%
	2%	22%	21%	20%	19%	18%	18%	17%	17%	16%	16%	15%	15%	15%
	4%	20%	19%	18%	17%	16%	16%	15%	15%	14%	14%	14%	13%	13%
	6%	20%	19%	18%	17%	16%	16%	15%	15%	14%	14%	14%	13%	13%
6%	0%	26%	24%	23%	23%	22%	21%	21%	20%	20%	20%	19%	19%	19%
	2%	24%	22%	21%	21%	20%	19%	19%	18%	18%	17%	17%	17%	16%
	4%	22%	20%	19%	19%	18%	17%	17%	16%	16%	16%	15%	15%	15%
	6%	22%	20%	19%	19%	18%	17%	17%	16%	16%	16%	15%	15%	15%
7%	0%	27%	26%	25%	24%	23%	23%	22%	22%	21%	21%	21%	21%	20%
	2%	25%	24%	23%	22%	21%	21%	20%	20%	19%	19%	19%	18%	18%
	4%	23%	22%	21%	20%	19%	19%	18%	18%	17%	17%	17%	17%	16%
	6%	23%	22%	21%	20%	19%	19%	18%	18%	17%	17%	17%	17%	16%
8%	0%	28%	27%	26%	25%	24%	24%	24%	23%	23%	23%	22%	21%	20%
	2%	27%	25%	24%	24%	23%	22%	22%	21%	21%	21%	20%	20%	20%
	4%	25%	23%	22%	22%	21%	20%	20%	19%	19%	19%	18%	18%	18%
	6%	24%	23%	22%	21%	20%	20%	20%	19%	19%	19%	18%	18%	18%
9%	0%	29%	28%	27%	26%	25%	25%	25%	25%	24%	23%	22%	21%	20%
	2%	28%	27%	26%	25%	24%	24%	23%	23%	22%	22%	22%	21%	20%
	4%	26%	25%	24%	23%	22%	22%	21%	21%	21%	20%	20%	20%	20%
	6%	25%	24%	23%	22%	21%	21%	21%	21%	20%	20%	20%	19%	19%
10%	0%	30%	29%	28%	27%	26%	26%	26%	26%	24%	23%	22%	21%	20%
	2%	29%	28%	27%	26%	25%	25%	25%	24%	24%	23%	22%	21%	20%
	4%	28%	26%	25%	25%	24%	23%	23%	22%	22%	22%	21%	21%	20%
	6%	26%	25%	24%	23%	22%	22%	22%	22%	21%	21%	21%	20%	20%
11%	0%	31%	30%	29%	28%	27%	27%	27%	26%	24%	23%	22%	21%	20%
	2%	30%	29%	28%	27%	26%	26%	26%	25%	24%	23%	22%	21%	20%
	4%	29%	27%	26%	26%	25%	24%	24%	24%	24%	23%	22%	21%	20%
	6%	27%	26%	25%	24%	23%	23%	23%	23%	22%	22%	22%	21%	20%
12%	0%	32%	31%	30%	29%	28%	28%	27%	26%	24%	23%	22%	21%	20%
	2%	31%	30%	29%	28%	27%	27%	27%	26%	24%	23%	22%	21%	20%
	4%	30%	28%	27%	27%	26%	25%	25%	25%	24%	23%	22%	21%	20%
	6%	28%	27%	26%	25%	24%	24%	24%	24%	23%	23%	22%	21%	20%

Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans

Table 2

What % of Pay is the Employer Willing to Contribute for the Lower Paid Employees?	What % of Pay is Expected to be Contributed by the Lower Paid Employees?	OWNER'S ANNUAL PAY												
		\$110,000	\$120,000	\$130,000	\$140,000	\$150,000	\$160,000	\$170,000	\$180,000	\$190,000	\$200,000	\$210,000	\$220,000	\$230,000
		CONTRIBUTION AMOUNT THAT CAN BE ACHIEVED FOR THE OWNER												
3%	0%	23,200	23,900	24,600	25,300	26,000	26,700	27,400	28,100	28,800	29,500	30,200	30,900	31,600
	2%	18,800	19,100	19,400	19,700	20,000	20,300	20,600	20,900	21,200	21,500	21,800	22,100	22,400
	4%	18,800	19,100	19,400	19,700	20,000	20,300	20,600	20,900	21,200	21,500	21,800	22,100	22,400
	6%	18,800	19,100	19,400	19,700	20,000	20,300	20,600	20,900	21,200	21,500	21,800	22,100	22,400
4%	0%	24,800	25,700	26,500	27,400	28,200	29,100	29,900	30,800	31,700	32,600	33,500	34,400	35,300
	2%	22,100	22,700	23,300	23,900	24,500	25,100	25,700	26,300	26,900	27,500	28,100	28,700	29,300
	4%	20,400	20,900	21,300	21,800	22,200	22,700	23,100	23,600	24,100	24,600	25,100	25,600	26,100
	6%	20,400	20,900	21,300	21,800	22,200	22,700	23,100	23,600	24,100	24,600	25,100	25,600	26,100
5%	0%	26,500	27,500	28,500	29,500	30,500	31,500	32,500	33,600	34,700	35,800	36,900	38,000	39,100
	2%	24,300	25,100	25,900	26,700	27,500	28,300	29,100	29,900	30,700	31,600	32,400	33,200	34,100
	4%	22,100	22,700	23,300	23,900	24,500	25,100	25,700	26,400	27,100	27,800	28,500	29,200	29,900
	6%	22,100	22,700	23,300	23,900	24,500	25,100	25,700	26,400	27,100	27,800	28,500	29,200	29,900
6%	0%	28,100	29,300	30,400	31,600	32,700	33,900	35,100	36,400	37,700	39,000	40,300	41,600	42,900
	2%	25,900	26,900	27,800	28,800	29,700	30,700	31,700	32,700	33,700	34,800	35,800	36,800	37,900
	4%	23,700	24,500	25,200	26,000	26,700	27,500	28,300	29,200	30,100	31,000	31,900	32,800	33,700
	6%	23,700	24,500	25,200	26,000	26,700	27,500	28,300	29,200	30,100	31,000	31,900	32,800	33,700
7%	0%	29,800	31,100	32,400	33,700	35,000	36,300	37,700	39,200	40,700	42,200	43,700	45,200	46,000
	2%	27,600	28,700	29,800	30,900	32,000	33,100	34,200	35,500	36,700	37,900	39,200	40,400	41,600
	4%	25,400	26,300	27,200	28,100	29,000	29,900	30,900	32,000	33,100	34,200	35,300	36,400	37,500
	6%	25,400	26,300	27,200	28,100	29,000	29,900	30,900	32,000	33,100	34,200	35,300	36,400	37,500
8%	0%	31,000	32,400	33,800	35,300	36,700	38,100	40,300	42,000	43,700	45,400	46,000	46,000	46,000
	2%	29,200	30,500	31,700	33,000	34,200	35,500	36,800	38,300	39,700	41,100	42,600	44,000	45,400
	4%	27,000	28,100	29,100	30,200	31,200	32,300	33,500	34,800	36,100	37,400	38,700	40,000	41,300
	6%	26,600	27,600	28,600	29,700	30,700	31,700	33,500	34,800	36,100	37,400	38,700	40,000	41,300
9%	0%	32,100	33,600	35,100	36,700	38,200	39,700	42,300	44,200	46,000	46,000	46,000	46,000	46,000
	2%	30,600	32,000	33,400	34,800	36,200	37,600	39,400	41,000	42,700	44,300	45,900	46,000	46,000
	4%	28,700	29,900	31,100	32,300	33,500	34,700	36,000	37,500	39,000	40,400	41,900	43,400	44,900
	6%	27,700	28,800	29,900	31,100	32,200	33,300	35,500	37,000	38,400	39,800	41,300	42,700	44,200
10%	0%	33,200	34,800	36,400	38,100	39,700	41,300	44,000	46,000	46,000	46,000	46,000	46,000	46,000
	2%	31,700	33,200	34,700	36,200	37,700	39,200	41,800	43,600	45,400	46,000	46,000	46,000	46,000
	4%	30,300	31,600	33,000	34,300	35,700	37,000	38,600	40,200	41,800	43,400	45,100	46,000	46,000
	6%	28,800	30,000	31,200	32,500	33,700	34,900	37,200	38,800	40,300	41,800	43,400	44,900	46,000
11%	0%	34,300	36,000	37,700	39,500	41,200	42,900	45,700	46,000	46,000	46,000	46,000	46,000	46,000
	2%	32,800	34,400	36,000	37,600	39,200	40,800	43,500	45,400	46,000	46,000	46,000	46,000	46,000
	4%	31,400	32,800	34,300	35,700	37,200	38,600	41,100	42,900	44,700	46,000	46,000	46,000	46,000
	6%	29,900	31,200	32,500	33,900	35,200	36,500	38,900	40,600	42,200	43,800	45,500	46,000	46,000
12%	0%	35,400	37,200	39,000	40,900	42,700	44,500	46,000	46,000	46,000	46,000	46,000	46,000	46,000
	2%	33,900	35,600	37,300	39,000	40,700	42,400	45,200	46,000	46,000	46,000	46,000	46,000	46,000
	4%	32,500	34,000	35,600	37,100	38,700	40,200	42,900	44,800	46,000	46,000	46,000	46,000	46,000
	6%	31,000	32,400	33,800	35,300	36,700	38,100	40,600	42,400	44,100	45,800	46,000	46,000	46,000

Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans

Table 3

What % of Pay is the Employer Willing to Contribute for the Lower Paid Employees?	What % of Pay is Expected to be Contributed by the Lower Paid Employees?	OWNER'S ANNUAL PAY												
		\$110,000	\$120,000	\$130,000	\$140,000	\$150,000	\$160,000	\$170,000	\$180,000	\$190,000	\$200,000	\$210,000	\$220,000	\$230,000
		RATIO OF OWNER'S CONTRIBUTION PERCENT TO THE EMPLOYER COST FOR LOWER PAID PARTICIPANTS												
3%	0%	7.0	6.6	6.3	6.0	5.8	5.6	5.4	5.2	5.1	4.9	4.8	4.7	4.6
	2%	5.7	5.3	5.0	4.7	4.4	4.2	4.0	3.9	3.7	3.6	3.5	3.3	3.2
	4%	5.7	5.3	5.0	4.7	4.4	4.2	4.0	3.9	3.7	3.6	3.5	3.3	3.2
	6%	5.7	5.3	5.0	4.7	4.4	4.2	4.0	3.9	3.7	3.6	3.5	3.3	3.2
4%	0%	5.6	5.4	5.1	4.9	4.7	4.5	4.4	4.3	4.2	4.1	4.0	3.9	3.8
	2%	5.0	4.7	4.5	4.3	4.1	3.9	3.8	3.7	3.5	3.4	3.3	3.2	3.2
	4%	4.6	4.4	4.1	3.9	3.7	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.8
	6%	4.6	4.4	4.1	3.9	3.7	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.8
5%	0%	4.8	4.6	4.4	4.2	4.1	3.9	3.8	3.7	3.7	3.6	3.5	3.5	3.4
	2%	4.4	4.2	4.0	3.8	3.7	3.5	3.4	3.3	3.2	3.2	3.1	3.0	3.0
	4%	4.0	3.8	3.6	3.4	3.3	3.1	3.0	2.9	2.9	2.8	2.7	2.7	2.6
	6%	4.0	3.8	3.6	3.4	3.3	3.1	3.0	2.9	2.9	2.8	2.7	2.7	2.6
6%	0%	4.3	4.1	3.9	3.8	3.6	3.5	3.4	3.4	3.3	3.3	3.2	3.2	3.1
	2%	3.9	3.7	3.6	3.4	3.3	3.2	3.1	3.0	3.0	2.9	2.8	2.8	2.7
	4%	3.6	3.4	3.2	3.1	3.0	2.9	2.8	2.7	2.6	2.6	2.5	2.5	2.4
	6%	3.6	3.4	3.2	3.1	3.0	2.9	2.8	2.7	2.6	2.6	2.5	2.5	2.4
7%	0%	3.9	3.7	3.6	3.4	3.3	3.2	3.2	3.1	3.1	3.0	3.0	2.9	2.9
	2%	3.6	3.4	3.3	3.2	3.0	3.0	2.9	2.8	2.8	2.7	2.7	2.6	2.6
	4%	3.3	3.1	3.0	2.9	2.8	2.7	2.6	2.5	2.5	2.4	2.4	2.4	2.3
	6%	3.3	3.1	3.0	2.9	2.8	2.7	2.6	2.5	2.5	2.4	2.4	2.4	2.3
8%	0%	3.5	3.4	3.3	3.2	3.1	3.0	3.0	2.9	2.9	2.8	2.7	2.6	2.5
	2%	3.3	3.2	3.1	2.9	2.9	2.8	2.7	2.7	2.6	2.6	2.5	2.5	2.5
	4%	3.1	2.9	2.8	2.7	2.6	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.2
	6%	3.0	2.9	2.8	2.7	2.6	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.2
9%	0%	3.2	3.1	3.0	2.9	2.8	2.8	2.8	2.7	2.7	2.6	2.4	2.3	2.2
	2%	3.1	3.0	2.9	2.8	2.7	2.6	2.6	2.5	2.5	2.5	2.4	2.3	2.2
	4%	2.9	2.8	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.2	2.2	2.2	2.2
	6%	2.8	2.7	2.6	2.5	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.2	2.1
10%	0%	3.0	2.9	2.8	2.7	2.6	2.6	2.6	2.6	2.4	2.3	2.2	2.1	2.0
	2%	2.9	2.8	2.7	2.6	2.5	2.5	2.5	2.4	2.4	2.3	2.2	2.1	2.0
	4%	2.8	2.6	2.5	2.5	2.4	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.0
	6%	2.6	2.5	2.4	2.3	2.2	2.2	2.2	2.2	2.1	2.1	2.1	2.0	2.0
11%	0%	2.8	2.7	2.6	2.6	2.5	2.4	2.4	2.3	2.2	2.1	2.0	1.9	1.8
	2%	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.2	2.1	2.0	1.9	1.8
	4%	2.6	2.5	2.4	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.0	1.9	1.8
	6%	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.1	2.0	2.0	2.0	1.9	1.8
12%	0%	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.1	2.0	1.9	1.8	1.7	1.7
	2%	2.6	2.5	2.4	2.3	2.3	2.2	2.2	2.1	2.0	1.9	1.8	1.7	1.7
	4%	2.5	2.4	2.3	2.2	2.2	2.1	2.1	2.1	2.0	1.9	1.8	1.7	1.7
	6%	2.4	2.3	2.2	2.1	2.0	2.0	2.0	2.0	1.9	1.9	1.8	1.7	1.7