# COMPARING RETIREMENT PLAN DESIGNS

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We are often asked to help companies design their retirement programs, given certain goals and objectives. Usually we find the employer is willing to spend a certain amount on staff, assuming sufficient company profits. Then a frequent question pertains to how much can be deferred for the owners, or other highly compensated employees, on a pre-tax basis.

When we help design a plan, we look at objectives, the need for flexibility, ages of the key personnel, salaries of everyone involved, total budgeted dollars, the advantages of adding 401(k) features, etc.

The following page shows the results of an analysis we prepared for one company that wanted a defined contribution plan. There were 10 people eligible for the retirement plan, including one owner.

We explained that we could consider “permitted disparity.” This recognizes that the company’s Social Security tax paid on behalf of the owner is a lesser percent than it is for the other employees. Consequently, we can make up for this by having their private industry plan give a higher contribution percent to the owner.

We could also consider age-weighting since the owner was older than most, but not all, of his employees. Considering 401(k) features, we could have a catch-up contribution for the owner, since he was over age 50. Also, by looking at 401(k) safe-harbor features, we could allow the owner to defer the maximum, even if his employees choose not to utilize the plan.

Also, due to ages, and the owner’s preference for giving all non-owners the same percent company contribution, we looked at “cross-testing” (also known as “new comparability”).

The owner was willing to contribute 5% of pay for his eligible staff. After looking at seven different designs, we sorted the results based on what we could do for the owner. The various designs resulted in total owner contributions that varied from $14,000 to $62,000, based on the compensation cap and contribution limits applicable for the current year. In other words, there were far more dramatic differences in the results than the owner thought possible. It’s just a matter of considering all the various rules and regulations applicable to qualified retirement plans.

Employers and their advisors should recognize that there is much more room for design enhancement than there was 10 to 20 years ago. Don’t assume that the simplest design is always the best!

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Here is an example showing the results of comparing seven plans for a small business. The owner was willing to spend on staff an amount equal to 5.0% of their total combined payroll. In this case, a cross-tested plan with 401(k) safe-harbor features was the best design. The results show the differences that can be obtained from various plan designs. The best design for any given situation will vary depending on employee ages and salaries, as well as company objectives.

| Plan: | | A | B | C | D | E | F | G |
|---|---|---|---|---|---|---|---|---|
| Description: | | Pro Rata Comp without 401(k) | Using Permitted Disparity without 401(k) | Age-Weighted without 401(k) | 401(k) Safe-Harbor with Permitted Disparity | Cross-Testing without 401(k) | Age Weighted with 401(k) Safe-Harbor | Cross-Testing with 401(k) Safe-Harbor |
| Employee Pay | Age | | | | | | | |
| **280,000** | **50** | **14,000** | **21,355** | **28,658** | **41,942** | **43,848** | **53,658** | **62,000** |
| 60,000 | 42 | 3,000 | 3,000 | 3,197 | 3,000 | 3,000 | 3,197 | 3,000 |
| 60,000 | 40 | 3,000 | 3,000 | 2,716 | 3,000 | 3,000 | 2,716 | 3,000 |
| 55,000 | 42 | 2,750 | 2,750 | 2,931 | 2,750 | 2,750 | 2,931 | 2,750 |
| 50,000 | 36 | 2,500 | 2,500 | 1,633 | 2,500 | 2,500 | 1,633 | 2,500 |
| 49,000 | 30 | 2,450 | 2,450 | 1,470 | 2,450 | 2,450 | 1,470 | 2,450 |
| 47,000 | 38 | 2,350 | 2,350 | 1,807 | 2,350 | 2,350 | 1,807 | 2,350 |
| 46,000 | 51 | 2,300 | 2,300 | 5,108 | 2,300 | 2,300 | 5,108 | 2,300 |
| 25,000 | 26 | 1,250 | 1,250 | 750 | 1,250 | 1,250 | 750 | 1,250 |
| 15,000 | 41 | 750 | 750 | 737 | 750 | 750 | 737 | 750 |
| Grand totals | | 34,350 | 41,705 | 49,008 | 62,292 | 64,198 | 74,008 | 82,350 |
| Percent of total to Owner | | 41% | 51% | 58% | 67% | 68% | 73% | 75% |
| Average contribution to non-owners as a percent of pay | | **5.0%** | **5.0%** | **5.0%** | **5.0%** | **5.0%** | **5.0%** | **5.0%** |

Assumptions:

1. Illustration uses the 2019 comp cap of $280,000, the contribution cap of $56,000, and the catch-up contribution cap of $6,000.
2. Plans B and D assume the integration level is the 2019 Social Security taxable wage base of $132,900.
3. Illustrations conservatively assume non-owners contribute nothing to any plan with a 401(k) provision.
4. The plan is top-heavy, meaning over 60% of the assets are attributed to Key Employees. Consequently, there is a 3% top-heavy minimum contribution for each non-key employee.
5. The safe-harbor contribution is the 3% non-elective contribution in Plans D, F, and G.