

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

2022

Many employers are debating how to most efficiently take advantage of the defined contribution limit increase to \$61,000. 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 with certain 401(k) features, the Highly Compensated Employees can defer the maximum with no concern about refunds due to low participation among rank-and-file employees.

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 certain officers and shareholders. In such a case, the employer must allocate to each “non-key” employee / participant at least 3% of pay in order for there to be significant contributions for key employees. 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:

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 (\$147,000 for 2022). 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 s/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, not only does the owner get that same 3% contribution, but s/he can defer an additional \$20,500 for 2022. 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 \$6,500 for the year 2022.

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.

| 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? | Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans | | | | | | | | | | | | |
|---|--|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | | OWNER'S ANNUAL PAY | | | | | | | | | | | | |
| | | \$185,000 | \$195,000 | \$205,000 | \$215,000 | \$225,000 | \$235,000 | \$245,000 | \$255,000 | \$265,000 | \$275,000 | \$285,000 | \$295,000 | \$305,000 |
| | | CONTRIBUTION PERCENT THAT CAN BE ACHIEVED FOR THE OWNER | | | | | | | | | | | | |
| 3% | 0% | 18% | 18% | 17% | 17% | 16% | 16% | 15% | 15% | 15% | 14% | 14% | 14% | 14% |
| | 2% | 14% | 14% | 13% | 13% | 12% | 12% | 11% | 11% | 11% | 10% | 10% | 10% | 10% |
| | 4% | 14% | 14% | 13% | 13% | 12% | 12% | 11% | 11% | 11% | 10% | 10% | 10% | 10% |
| | 6% | 14% | 14% | 13% | 13% | 12% | 12% | 11% | 11% | 11% | 10% | 10% | 10% | 10% |
| 4% | 0% | 20% | 19% | 19% | 18% | 18% | 17% | 17% | 17% | 16% | 16% | 16% | 16% | 15% |
| | 2% | 17% | 17% | 16% | 16% | 15% | 15% | 14% | 14% | 14% | 13% | 13% | 13% | 13% |
| | 4% | 16% | 15% | 15% | 14% | 14% | 13% | 13% | 13% | 12% | 12% | 12% | 12% | 11% |
| | 6% | 16% | 15% | 15% | 14% | 14% | 13% | 13% | 13% | 12% | 12% | 12% | 12% | 11% |
| 5% | 0% | 21% | 21% | 20% | 20% | 19% | 19% | 18% | 18% | 18% | 18% | 17% | 17% | 17% |
| | 2% | 19% | 19% | 18% | 18% | 17% | 17% | 16% | 16% | 16% | 16% | 15% | 15% | 15% |
| | 4% | 17% | 17% | 16% | 16% | 15% | 15% | 14% | 14% | 14% | 14% | 13% | 13% | 13% |
| | 6% | 17% | 17% | 16% | 16% | 15% | 15% | 14% | 14% | 14% | 14% | 13% | 13% | 13% |
| 6% | 0% | 23% | 22% | 22% | 21% | 21% | 20% | 20% | 20% | 19% | 19% | 19% | 19% | 19% |
| | 2% | 21% | 20% | 20% | 19% | 19% | 18% | 18% | 18% | 17% | 17% | 17% | 17% | 16% |
| | 4% | 19% | 18% | 18% | 17% | 17% | 16% | 16% | 16% | 15% | 15% | 15% | 15% | 15% |
| | 6% | 19% | 18% | 18% | 17% | 17% | 16% | 16% | 16% | 15% | 15% | 15% | 15% | 15% |
| 7% | 0% | 24% | 24% | 23% | 23% | 22% | 22% | 21% | 21% | 21% | 21% | 21% | 20% | 20% |
| | 2% | 22% | 22% | 21% | 21% | 20% | 20% | 19% | 19% | 19% | 19% | 18% | 18% | 18% |
| | 4% | 20% | 20% | 19% | 19% | 18% | 18% | 17% | 17% | 17% | 17% | 17% | 16% | 16% |
| | 6% | 20% | 20% | 19% | 19% | 18% | 18% | 17% | 17% | 17% | 17% | 17% | 16% | 16% |
| 8% | 0% | 25% | 25% | 24% | 24% | 23% | 23% | 23% | 23% | 23% | 22% | 21% | 21% | 20% |
| | 2% | 24% | 23% | 23% | 22% | 22% | 21% | 21% | 21% | 20% | 20% | 20% | 20% | 20% |
| | 4% | 22% | 21% | 21% | 20% | 20% | 19% | 19% | 19% | 19% | 18% | 18% | 18% | 18% |
| | 6% | 21% | 21% | 20% | 20% | 19% | 19% | 19% | 19% | 19% | 18% | 18% | 18% | 18% |
| 9% | 0% | 26% | 26% | 25% | 25% | 24% | 24% | 24% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 2% | 25% | 24% | 24% | 23% | 23% | 23% | 22% | 22% | 22% | 22% | 21% | 21% | 20% |
| | 4% | 23% | 23% | 22% | 22% | 21% | 21% | 20% | 20% | 20% | 20% | 20% | 19% | 19% |
| | 6% | 22% | 22% | 21% | 21% | 20% | 20% | 20% | 20% | 20% | 20% | 19% | 19% | 19% |
| 10% | 0% | 27% | 27% | 26% | 26% | 25% | 25% | 25% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 2% | 26% | 25% | 25% | 24% | 24% | 24% | 24% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 4% | 25% | 24% | 24% | 23% | 23% | 22% | 22% | 22% | 22% | 21% | 21% | 21% | 20% |
| | 6% | 23% | 23% | 22% | 22% | 21% | 21% | 21% | 21% | 21% | 21% | 20% | 20% | 20% |
| 11% | 0% | 28% | 28% | 27% | 27% | 26% | 26% | 25% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 2% | 27% | 26% | 26% | 25% | 25% | 25% | 25% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 4% | 26% | 25% | 25% | 24% | 24% | 23% | 23% | 23% | 23% | 22% | 21% | 21% | 20% |
| | 6% | 24% | 24% | 23% | 23% | 22% | 22% | 22% | 22% | 22% | 22% | 21% | 21% | 20% |
| 12% | 0% | 29% | 29% | 28% | 28% | 27% | 26% | 25% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 2% | 28% | 27% | 27% | 26% | 26% | 26% | 25% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 4% | 27% | 26% | 26% | 25% | 25% | 24% | 25% | 24% | 23% | 22% | 21% | 21% | 20% |
| | 6% | 25% | 25% | 24% | 24% | 23% | 23% | 23% | 23% | 23% | 22% | 21% | 21% | 20% |

| 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? | Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans | | | | | | | | | | | | Table 2 |
|---|--|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | | OWNER'S ANNUAL PAY | | | | | | | | | | | | |
| | | \$185,000 | \$195,000 | \$205,000 | \$215,000 | \$225,000 | \$235,000 | \$245,000 | \$255,000 | \$265,000 | \$275,000 | \$285,000 | \$295,000 | \$305,000 |
| | | CONTRIBUTION AMOUNT THAT CAN BE ACHIEVED FOR THE OWNER | | | | | | | | | | | | |
| 3% | 0% | 33,400 | 34,100 | 34,800 | 35,500 | 36,200 | 36,900 | 37,600 | 38,300 | 39,000 | 39,700 | 40,400 | 41,100 | 41,800 |
| | 2% | 26,000 | 26,300 | 26,600 | 26,900 | 27,200 | 27,500 | 27,800 | 28,100 | 28,400 | 28,700 | 29,000 | 29,300 | 29,600 |
| | 4% | 26,000 | 26,300 | 26,600 | 26,900 | 27,200 | 27,500 | 27,800 | 28,100 | 28,400 | 28,700 | 29,000 | 29,300 | 29,600 |
| | 6% | 26,000 | 26,300 | 26,600 | 26,900 | 27,200 | 27,500 | 27,800 | 28,100 | 28,400 | 28,700 | 29,000 | 29,300 | 29,600 |
| 4% | 0% | 36,200 | 37,100 | 37,900 | 38,800 | 39,600 | 40,500 | 41,300 | 42,200 | 43,100 | 44,000 | 44,900 | 45,800 | 46,700 |
| | 2% | 31,600 | 32,200 | 32,800 | 33,400 | 34,000 | 34,600 | 35,200 | 35,800 | 36,400 | 37,000 | 37,600 | 38,200 | 38,800 |
| | 4% | 28,800 | 29,300 | 29,700 | 30,200 | 30,600 | 31,100 | 31,500 | 32,000 | 32,500 | 33,000 | 33,500 | 34,000 | 34,500 |
| | 6% | 28,800 | 29,300 | 29,700 | 30,200 | 30,600 | 31,100 | 31,500 | 32,000 | 32,500 | 33,000 | 33,500 | 34,000 | 34,500 |
| 5% | 0% | 39,000 | 40,000 | 41,000 | 42,000 | 43,000 | 44,000 | 45,000 | 46,100 | 47,200 | 48,300 | 49,400 | 50,500 | 51,600 |
| | 2% | 35,300 | 36,100 | 36,900 | 37,700 | 38,500 | 39,300 | 40,100 | 40,900 | 41,700 | 42,600 | 43,400 | 44,200 | 45,100 |
| | 4% | 31,600 | 32,200 | 32,800 | 33,400 | 34,000 | 34,600 | 35,200 | 35,900 | 36,600 | 37,300 | 38,000 | 38,700 | 39,400 |
| | 6% | 31,600 | 32,200 | 32,800 | 33,400 | 34,000 | 34,600 | 35,200 | 35,900 | 36,600 | 37,300 | 38,000 | 38,700 | 39,400 |
| 6% | 0% | 41,800 | 43,000 | 44,100 | 45,300 | 46,400 | 47,600 | 48,800 | 50,100 | 51,400 | 52,700 | 54,000 | 55,300 | 56,600 |
| | 2% | 38,100 | 39,000 | 40,000 | 40,900 | 41,900 | 42,800 | 43,800 | 44,800 | 45,900 | 46,900 | 47,900 | 49,000 | 50,000 |
| | 4% | 34,400 | 35,200 | 35,900 | 36,700 | 37,400 | 38,200 | 39,000 | 39,900 | 40,800 | 41,700 | 42,600 | 43,500 | 44,400 |
| | 6% | 34,400 | 35,200 | 35,900 | 36,700 | 37,400 | 38,200 | 39,000 | 39,900 | 40,800 | 41,700 | 42,600 | 43,500 | 44,400 |
| 7% | 0% | 44,600 | 45,900 | 47,200 | 48,500 | 49,800 | 51,100 | 52,500 | 54,000 | 55,500 | 57,000 | 58,500 | 60,000 | 61,000 |
| | 2% | 40,900 | 42,000 | 43,100 | 44,200 | 45,300 | 46,400 | 47,500 | 48,800 | 50,000 | 51,200 | 52,500 | 53,700 | 54,900 |
| | 4% | 37,200 | 38,100 | 39,000 | 39,900 | 40,800 | 41,700 | 42,700 | 43,800 | 44,900 | 46,000 | 47,100 | 48,200 | 49,300 |
| | 6% | 37,200 | 38,100 | 39,000 | 39,900 | 40,800 | 41,700 | 42,700 | 43,800 | 44,900 | 46,000 | 47,100 | 48,200 | 49,300 |
| 8% | 0% | 46,700 | 48,200 | 49,600 | 51,000 | 52,400 | 53,800 | 56,200 | 57,900 | 59,600 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 2% | 43,700 | 44,900 | 46,200 | 47,400 | 48,700 | 49,900 | 51,300 | 52,700 | 54,100 | 55,600 | 57,000 | 58,400 | 59,900 |
| | 4% | 40,000 | 41,000 | 42,100 | 43,100 | 44,200 | 45,200 | 46,400 | 47,700 | 49,000 | 50,300 | 51,600 | 52,900 | 54,200 |
| | 6% | 39,300 | 40,400 | 41,400 | 42,400 | 43,400 | 44,400 | 46,400 | 47,700 | 49,000 | 50,300 | 51,600 | 52,900 | 54,200 |
| 9% | 0% | 48,600 | 50,100 | 51,600 | 53,100 | 54,600 | 56,200 | 59,200 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 2% | 46,100 | 47,500 | 48,900 | 50,300 | 51,600 | 53,000 | 55,000 | 56,600 | 58,200 | 59,900 | 61,000 | 61,000 | 61,000 |
| | 4% | 42,800 | 44,000 | 45,200 | 46,400 | 47,600 | 48,800 | 50,100 | 51,600 | 53,100 | 54,500 | 56,000 | 57,500 | 58,900 |
| | 6% | 41,200 | 42,300 | 43,400 | 44,500 | 45,600 | 46,800 | 49,400 | 50,800 | 52,300 | 53,700 | 55,100 | 56,600 | 58,000 |
| 10% | 0% | 50,400 | 52,100 | 53,700 | 55,300 | 56,900 | 58,500 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 2% | 48,000 | 49,500 | 50,900 | 52,400 | 53,900 | 55,400 | 58,400 | 60,200 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 4% | 45,500 | 46,900 | 48,200 | 49,500 | 50,900 | 52,200 | 53,800 | 55,400 | 57,000 | 58,600 | 60,300 | 61,000 | 61,000 |
| | 6% | 43,000 | 44,300 | 45,500 | 46,700 | 47,900 | 49,100 | 51,800 | 53,400 | 54,900 | 56,400 | 58,000 | 59,500 | 61,000 |
| 11% | 0% | 52,300 | 54,000 | 55,700 | 57,400 | 59,100 | 60,900 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 2% | 49,800 | 51,400 | 53,000 | 54,600 | 56,100 | 57,700 | 60,800 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 4% | 47,400 | 48,800 | 50,200 | 51,700 | 53,100 | 54,600 | 57,500 | 59,200 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 6% | 44,900 | 46,200 | 47,500 | 48,800 | 50,100 | 51,500 | 54,300 | 55,900 | 57,600 | 59,200 | 60,800 | 61,000 | 61,000 |
| 12% | 0% | 54,100 | 56,000 | 57,800 | 59,600 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 2% | 51,700 | 53,400 | 55,000 | 56,700 | 58,400 | 60,100 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 4% | 49,200 | 50,800 | 52,300 | 53,800 | 55,400 | 56,900 | 60,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 | 61,000 |
| | 6% | 46,700 | 48,200 | 49,600 | 51,000 | 52,400 | 53,800 | 56,700 | 58,500 | 60,200 | 61,000 | 61,000 | 61,000 | 61,000 |