



Small Business Retirement Plans: Maximizing Contributions

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Defined Contribution or Defined Benefit

- ▶ Defined Benefit Plan – Promised Benefit. Provides a fixed, pre-established benefit for employees at retirement. Contributions to defined benefit plans are generally greater per year than to a defined contribution plan.
 - ▶ Pension Plans
 - ▶ Money Purchase Pension Plans
 - ▶ Cash Balance Pension Plans
- ▶ Defined Contribution Plan – Contributions to individual account. Employee and/or Employer contribute to employee's individual account under the plan. The amount of the account at the time of distribution includes the contributions and investment gains and losses minus any investment and administrative fees.
 - ▶ Profit Sharing Plans
 - ▶ 401(k) Plans
 - ▶ SIMPLE Plans
 - ▶ ESOPs

Defined Contribution Plan Contribution Limitations

- ▶ Total contribution limit for Internal Revenue Code (“IRC”) Section 401 (a) defined contribution plans under IRC Section 415(c)(1)(A) is \$54,000 (2017). This is a plan limitation.
- ▶ Elective Deferral limit is \$18,000 (2017). This is an individual limit. *
- ▶ Catch up deferral limit is \$6,000 (2017). This is an individual limit and not counted in plan IRC Section 415(c)(1)(A). *
 - ▶ Example:
 - ▶ Participant is 55 a highly compensated employee with compensation of \$300,000 and participates in employer 401(k) Profit Sharing Plan. Participant defers \$18,000. Employer’s profit sharing contribution to Participant is limited to \$36,000. Participant is now maxed at \$54,000 limit but can defer an additional \$6,000 catch up contribution.
 - ▶ Participant above is employed at a different company which also sponsors a 401(k) Profit Sharing Plan. Participant may not defer any additional compensation as 401(k) deferrals since Participant has hit her individual deferral limit. The second company can contribute the maximum of \$54,000 to the Participant’s account.
- ▶ SIMPLE deferral limit is \$12,500 (2017). Employer must match dollar for dollar up to 3% of employee’s compensation. If Employer does not match, the a required non-elective contribution of 2% of compensation (up to \$270,000 (2017)) for all eligible employees.

* Elective deferrals are subject to employment taxes and are considered first dollars of the taxable wage base; for highly compensated employees who are targets for enhanced contribution designs in S corporations or other flow through entities and under 50, consider making contribution fully in form of employer contribution and not elective deferrals.

Defined Contribution Deduction Limitation

- ▶ Total deductible contribution to Plan is 25% of covered compensation.
- ▶ Compensation limitation is \$270,000.
- ▶ Elective deferral and catch up deferrals are not considered employer contributions and are not subject to the employer deduction limitation relating to the 25% of compensation limitation for defined contribution plans.

Defined Benefit Plan Contribution Limitation

- ▶ Contributions to a defined benefit plan are based on what is needed to provide for the promised benefit to the plan participants. Actuarial assumptions and computations are required to determine the contribution amount.
- ▶ In general, the annual benefit for a participant under a defined benefit plan cannot exceed the lesser of
 - ▶ 100% of the participant's average compensation for his highest 3 consecutive calendar years; or
 - ▶ \$215,000 (2017).
- ▶ Example: 58 year old cash balance pension plan participant with compensation of \$260,000. In the first year of the Plan in order to fund a maximum permitted benefit a contribution of \$220,000 is required. A 62 year old with the same compensation will require a contribution of \$268,500 to fund a maximum benefit.

Safe Harbor 401 (k) Plans

- ▶ An option to avoid limitations on deferral amounts for highly compensated employees due to non-discrimination testing.
- ▶ Two ways to satisfy safe harbor
 - ▶ Matching formula – 100% of the first 3% of compensation deferred, then 50% of the next 2% of compensation deferred. Essentially a 4% match. Applied to only participants deferring compensation.
 - ▶ Non-elective formula – 3% of compensation contribution for all eligible participants.
- ▶ Limitations and problems with Match Formula? Top Heavy, Non-elective contributions and Cross testing and why it needs to be tested for effectiveness looking forward.

Questions

- ▶ What is the goal of the Plan design?
- ▶ What options are there to maximize contributions and deductions?
- ▶ What designs work best with organizations?