Retirement Plan Design Opportunities for Law Firms and Their Small Business Clients

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Retirement Plan Services Director

UPDATED | NOVEMBER, 2014
RETIREMENT PLAN OPPORTUNITIES

Learning Objectives

• To increase the lawyer’s understanding of several benefits of IRS-qualified plans for small businesses in order to include retirement plan solutions when consulting to clients;

• To identify different types of qualified plans (IRA-Based, Defined Contribution, and Defined Benefit Plans) and unique features best suited for law firms and their clients;

• To help lawyers understand how, when and why a retirement plan can be optimized to benefit business owners within legal limitations per ERISA law;

• To identify the differences between types of service providers in order to best counsel clients.

PRESENTATION OVERVIEW

• Types of Employer-Sponsored, Tax-Qualified Retirement Plans

• Why Adopt A Qualified Retirement Plan?

• Comparing Plan Types

• Selecting a Plan and Service Provider(s)
TYPES OF QUALIFIED RETIREMENT PLANS

- IRA Based Plans
  - SEP – Simplified Employee Pension Plan
  - SIMPLE – Savings Incentive Match Plan for Employees

- Defined Contribution Plans
  - Money Purchase
  - Profit Sharing
  - 401(k) – Traditional & Safe Harbor
  - Owner-Only 401(k)

- Defined Benefit Pension Plans
  - Traditional Defined Benefit
  - Cash Balance
  - Owner-Only DB

- Combo DC & DB
  - Cash Balance + SH 401(k) & Tiered PS

Savings Tool
- Retirement can last for 30-40 years, and retirees may need 80% of pre-retirement annual income to retire comfortably
- Average annual Social Security benefit amount is only $14,124
- Plan allows automated deposits: benefit from inertia, dollar-cost averaging
- Plan design optimization: allows owners to catch up retirement savings

Tax Planning Tool
- Pre-tax contributions: defer income tax, put more of your money to work for you with compounded interest, before it works for Uncle Sam
- Roth contributions: presumably pay lower income tax now, then take tax-free distribution when in higher tax bracket
- Saver’s Credit for low/moderate-income workers

Assets Protection Tool
- Federal protection from creditors under ERISA
- Greater protection than IRAs

Employee-Demanded Tool
- The primary source of retirement savings for 60-80% of today’s workers
- 87% say a 401(k) is a “must-have” benefit
- Growing movement to require employer-sponsored plans

WHY ADOPT A QUALIFIED RETIREMENT PLAN?
WHY ADOPT A QUALIFIED RETIREMENT PLAN?

The Advantage of Saving Early... And The Cost Of Waiting

Assumes single deposit of $1,000 at beginning of each year; 6% annual return.
This chart is hypothetical and for illustrative purposes only. It is not indicative of any particular investments.

If saved from age 21 to 65

Total $211,744 Total amount at 65

$44,000 Total Saved

$167,744 Investment Gain

If saved from age 31 to 65

Total $110,435 Total amount at 65

$34,000 Total Saved

$76,435 Investment Gain

WHY ADOPT A QUALIFIED RETIREMENT PLAN?

The Advantage of Saving Early and Often

• Sally is age 25, and annual salary is $40,000
• She contributes 10% of her paycheck to her 401(k) ($4,000/year)
• Employer matches first 2% deferred
• Annual contribution is $4,800 to her account each year
  • Her annual out of pocket cost is approx. $3,200
  • She defers annual income taxes of $800
• How much will Sally have if her account earns a 6% annual investment return? 8%?

<table>
<thead>
<tr>
<th>at Age</th>
<th>IR = 6 %</th>
<th>IR = 8%</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td>$63,400</td>
<td>$69,680</td>
</tr>
<tr>
<td>45</td>
<td>$176,939</td>
<td>$220,115</td>
</tr>
<tr>
<td>55</td>
<td>$380,270</td>
<td>$544,892</td>
</tr>
<tr>
<td>65*</td>
<td>$744,405</td>
<td>$1,246,062</td>
</tr>
</tbody>
</table>

*After 40 years Sally’s actual contributions would be only $160,000, and $32,000 of that would have gone to Uncle Sam
WHY ADOPT A QUALIFIED RETIREMENT PLAN?

What Are Your Objectives, Business Owner?

1. Provide benefits for employees?
   - “Keep it simple, low-cost!” Simply provide a cost-effective means for employees to save for retirement, or
   - “Help my employees!” Help employees prepare for financially sound retirement as much as possible, including significant employer contributions and education.

2. Maximize contributions for owners and/or key employees?
   - “Optimize the plan for me!” Maximize contributions for owners, minimize for other employees, or
   - “Take care of employees!” Contribute more for other employees, too.

WHY ADOPT A QUALIFIED RETIREMENT PLAN?

Additional Resources

- IRS & DOL Publications:
  - 401(k) Plans for Small Businesses (Publication 4222)
  - Automatic Enrollment (publication 4674)
  - Payroll Deduction IRA for Small Businesses (Publication 4587)
  - Profit Sharing Plans for Small Businesses (Publication 4886)
  - SEP Retirement Plans for Small Businesses (Publication 4333)
  - SIMPLE IRA Plans for Small Businesses (Publication 4334)
- IRS (www.irs.gov/retirement):
  - Choosing a Retirement Solution for Your Small Business (Publication 3998)
  - lots of benefits of employee-retirement plans (Publication 4118)
  - Series of Retirement Plans
  - New & Existing Plans
  - New Employees Saving Tips – Time Is On Your Side
  - Webcasts – Easy Low Cost Retirement Plans for Your Small Business
  - Tips for Employers Using Pre-Approved Plans
- DOL (www.dol.gov/ebsa/publications):
  - Adding Automatic Enrollment To Your 401(k) Plan
  - Choosing A Retirement Solution for Your Small Business
  - Cash Balance Plans Questions and Answers
  - Retirement Tools
  - Savings Fitness: A Guide to Your Money and Your Financial Future
  - Planning The Mystery Out Of Retirement Planning
  - Top 10 Ways to Prepare for Retirement
  - What You Should Know About Your Retirement Plan
- Other:
  - Ballpark Estimate Retirement Calculator (www.choosetosave.org/ballpark)
  - Retirement Calculator (http://apps.fina.org/Calc/i3/savings)
  - Social Security Retirement Planner (www.ssa.gov/planners/retire)
COMPARISON OF PLAN TYPES

In a nutshell... how much can be contributed?

- IRA Plans (SEP & SIMPLE) =

- Defined Contribution Plans =

- Defined Benefit Plans =
IRA BASED PLANS

SEP & SIMPLE Characteristics

• Limited contribution structure
• Inexpensive
• Minimal recordkeeping and reporting
  • No non-discrimination testing
  • No Form 5500
• All contributions 100% vested
• No loans
• In-service distributions allowed, subject to early withdrawal tax penalty
• Generally not an ERISA qualified retirement plan

Simplified Employee Pension (SEP)

• Eligible Employers:
  • Any size or type of company
  • Typically best for small companies with few employees, especially if only employees are owner’s family members
• Eligible Employee*:
  • Has reached age 21
  • Has worked for the employer in at least 3 of the last 5 years
  • Received at least $600 in compensation from the employer during the year (2015)

*Note: Employer may use less restrictive requirements
IRA BASED PLANS

Simplified Employee Pension (SEP)

- Only employer contributions
- Contributions not required
- Contribution limits:
  - Plan contribution limited to 25% of compensation
  - Individual allocation limited to $53,000 for 2015 (indexed)
  - Maximum compensation considered in calculation is $265,000 for 2015 (indexed)
- Can be established up to tax filing deadline

* For Sole Proprietors with no employees, the “effective” maximum deduction is 20% of covered compensation since the profit sharing contribution reduces the Sole Proprietor’s starting compensation

**Example of SEP Contributions**

<table>
<thead>
<tr>
<th>Employee</th>
<th>Total Compensation</th>
<th>10% Contribution On Total Compensation (A x 10%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janet (Owner)</td>
<td>$265,000</td>
<td>$26,500</td>
</tr>
<tr>
<td>Brian</td>
<td>$105,000</td>
<td>$10,500</td>
</tr>
<tr>
<td>Jill</td>
<td>$65,000</td>
<td>$6,500</td>
</tr>
<tr>
<td>Tracy</td>
<td>$30,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Chris</td>
<td>$20,000</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

**Owner’s Portion:** 54.6%
Savings Incentive Match Plan for Employees (SIMPLE)

- **Eligible Employers:**
  - 100 or less employees who received $5,000* or more in compensation during the preceding year
  - Must be the only retirement plan maintained during the calendar year

- **Eligible Employees:**
  - Generally, any employee who received at least $5,000* or more in compensation in the preceding year (can be less restrictive)

*Note: Employer may choose a less restrictive amount.

Employee contributions

- Salary deferral of up to $12,500 (for 2015, indexed)
- Catch-up contributions of $3,000 (for 2015, indexed), if age 50 or older

Employer required contributions equal to:

- Non-elective contribution of 2% of compensation*
  - *Only first $265,000 of compensation, indexed; or
- Match equal to 100% of first 3%** of comp deferred
  - **Limited exception = can be 1% in up to 2 out of 5 years

No additional contributions allowed

In-service distributions:

- 25% penalty (instead of 10%) if withdrawn in first 2 years
- Generally, must be established by October 1st of current year
### DC PLANS

#### Savings Incentive Match Plan for Employees (SIMPLE)

<table>
<thead>
<tr>
<th>Name</th>
<th>Salary</th>
<th>Deferral</th>
<th>Company</th>
<th>Total for Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janet (owner)</td>
<td>$300,000</td>
<td>$15,500</td>
<td>$5,300</td>
<td>$20,800</td>
</tr>
<tr>
<td>Brian</td>
<td>$105,000</td>
<td>$5,000</td>
<td>$2,100</td>
<td>$7,100</td>
</tr>
<tr>
<td>Jill</td>
<td>$65,000</td>
<td>$5,000</td>
<td>$1,300</td>
<td>$6,300</td>
</tr>
<tr>
<td>Tracy</td>
<td>$30,000</td>
<td>$3,000</td>
<td>$600</td>
<td>$3,600</td>
</tr>
<tr>
<td>Chris</td>
<td>$20,000</td>
<td>$200</td>
<td>$400</td>
<td>$400</td>
</tr>
<tr>
<td><strong>Totals:</strong></td>
<td>$320,000</td>
<td>$9,700</td>
<td></td>
<td><strong>$20,800</strong></td>
</tr>
</tbody>
</table>

**Owner’s Percentage:** 54.6%

### with 3% Match

<table>
<thead>
<tr>
<th>Name</th>
<th>Deferral</th>
<th>Company</th>
<th>Total for Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janet (owner)</td>
<td>$15,500</td>
<td>$9,000</td>
<td>$24,500</td>
</tr>
<tr>
<td>Brian</td>
<td>$5,000</td>
<td>$3,150</td>
<td>$8,150</td>
</tr>
<tr>
<td>Jill</td>
<td>$5,000</td>
<td>$1,950</td>
<td>$6,950</td>
</tr>
<tr>
<td>Tracy</td>
<td>$3,000</td>
<td>$900</td>
<td>$3,900</td>
</tr>
<tr>
<td>Chris</td>
<td>$200</td>
<td>$200</td>
<td>$400</td>
</tr>
<tr>
<td><strong>Totals:</strong></td>
<td>$15,200</td>
<td></td>
<td><strong>$15,200</strong></td>
</tr>
</tbody>
</table>

**Owner’s Percentage:** 59.2%

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### DEFINED CONTRIBUTION PLANS

**Profit Sharing and 401(k)**
DC PLANS

Profit Sharing and 401(k) Characteristics

- Qualified plan assets held in a trust subject to ERISA
- Employer contributions may be mandatory or discretionary
- Investments may be directed by trustees or by participants
- Individual balance for each participant
- Plan does not promise to pay a specific dollar benefit at retirement
- Non-discrimination and coverage testing requirements
- Must be established by the last day of the business fiscal year

Profit Sharing and 401(k) Characteristics

- Maximum compensation of $265,000 considered in calculations (for 2015, indexed)
- Contribution limits:
  - Plan contribution limited to 25%* of total eligible compensation
  - Individual allocations limited to the lesser of $53,000 or 100% of compensation
- Eligibility requirements can limit participation
  - One year of service for 401(k) (12 Months & 1,000 Hours)
  - Two years for employer contributions
    - Requires immediate vesting
  - Minimum age 21

* For Sole Proprietors with no employees, the “effective” maximum deduction is 20% of covered compensation since the profit sharing contribution reduces the Sole Proprietor's starting compensation
DC PLANS

**Profit Sharing and 401(k) Characteristics**

- Vesting: Up to 6 years vesting schedule can improve employee retention and creates forfeitures
- Forfeitures can be reallocated to remaining participants, or used to pay expenses or reduce future employer contributions
- Loans, in-service distributions permitted

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**Profit Sharing Plans**

- Company need not be profitable to make discretionary profit sharing contributions
- Annual allocation conditions - plan can require either or both:
  - As much as 1000 hours worked
  - Employment on last day of plan year
- Contribution allocation based upon compensation or compensation and age
  - **Pro-rata** Allocation (standard)
  - Social Security **Integrated** Allocation (“Permitted Disparity”)
  - **Tiered** Allocation (a.k.a. “New-Comparability”, “Cross-Tested”, or “Age-Based”)
Profit Sharing Allocation: Social Security Integration

- AKA “Permitted Disparity”
- Provides extra contribution for those with compensation above a certain threshold
- Takes into consideration certain Social Security benchmarks
  - Social Security Wage Base $118,500 for 2015
  - Old Age Survivors Disability Insurance – 5.7%

Employee Compensation

<table>
<thead>
<tr>
<th>Employee</th>
<th>Total Compensation</th>
<th>10% Contribution On Total Compensation</th>
<th>Compensation In Excess Of SS Wage Base*</th>
<th>5.7% Contribution on Excess Comp</th>
<th>Total Contribution</th>
<th>Actual Contribution Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janet (Owner)</td>
<td>$265,000</td>
<td>$26,500</td>
<td>$146,500</td>
<td>$8,350</td>
<td>$34,850</td>
<td>13.15%</td>
</tr>
<tr>
<td>Brian</td>
<td>$105,000</td>
<td>$10,500</td>
<td>$6,500</td>
<td>$0</td>
<td>$6,500</td>
<td>10.00%</td>
</tr>
<tr>
<td>Jill</td>
<td>$65,000</td>
<td>$6,500</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>10.00%</td>
</tr>
<tr>
<td>Tracy</td>
<td>$30,000</td>
<td>$3,000</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>10.00%</td>
</tr>
<tr>
<td>Chris</td>
<td>$20,000</td>
<td>$2,000</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>10.00%</td>
</tr>
</tbody>
</table>

Owner’s Portion: 54.6% 61.3%

* Alternatively, can use a fraction of SS Wage Base, which may lower excess contribution rate.
DC PLANS

Profit Sharing Allocation: Tiered or Age-Based

• AKA “New-Comparability” or “Cross-Tested” or “Class Allocation”
• A Profit Sharing contribution using different allocation rates for different categories of employees
• Special age-based testing applies to these plans
• Dramatically favors owners who are older than most employees
• The higher the owner’s pay, the lower the PS rate for employees
• IRS filing fees may apply

Characteristics of a Tiered Plan candidate:
• Owners are older than most of the employees, or have at least one or a few very young employees
• Owners make more than most employees (the higher the owner’s compensation, the better)
• At least one owner wants to increase his/her own contribution, up to $53,000
• Or owners want moderate contributions for themselves with minimal contributions for employees
• Or owners want to maintain level of contributions but reduce their own compensation and income/payroll taxes
### Profit Sharing Allocation: Tiered or Age-Based

- **Objective:** Maximize contribution for older owners/HCEs

#### Standard PS or SEP

<table>
<thead>
<tr>
<th>Employee</th>
<th>Comp</th>
<th>Standard 10% Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janet (Owner)</td>
<td>$265,000</td>
<td>$26,500</td>
</tr>
<tr>
<td>Brian</td>
<td>$105,000</td>
<td>$10,500</td>
</tr>
<tr>
<td>Jill</td>
<td>$65,000</td>
<td>$6,500</td>
</tr>
<tr>
<td>Tracy</td>
<td>$30,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Chris</td>
<td>$20,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$485,000</td>
<td>$48,500</td>
</tr>
</tbody>
</table>

#### SS Integrated Profit Sharing

<table>
<thead>
<tr>
<th>10% Contribution</th>
<th>Contrib Rate</th>
<th>Integrated PS</th>
<th>Contrib Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$34,850</td>
<td>13.15%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Tiered Profit Sharing

<table>
<thead>
<tr>
<th>Age</th>
<th>Tiered Profit Sharing Contribution</th>
<th>Contrib Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>$53,000</td>
<td>20%</td>
</tr>
<tr>
<td>48</td>
<td>$5,250</td>
<td>5%</td>
</tr>
<tr>
<td>32</td>
<td>$3,250</td>
<td>5%</td>
</tr>
<tr>
<td>25</td>
<td>$1,500</td>
<td>5%</td>
</tr>
<tr>
<td>21</td>
<td>$1,000</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td>$64,000</td>
<td></td>
</tr>
</tbody>
</table>

**Owner’s Portion:** 54.6%  
**Cost Reduction:** $11,000

**Additional Total Deduction:** $7,150  
**Additional Savings for Owner:** $18,150

---

### Profit Sharing Allocation: Tiered or Age-Based

- **Objective:** Reduce contribution for employees

#### Standard PS or SEP

<table>
<thead>
<tr>
<th>Employee</th>
<th>Comp</th>
<th>Standard 10% Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janet (Owner)</td>
<td>$265,000</td>
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</tr>
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<td>Brian</td>
<td>$105,000</td>
<td>$10,500</td>
</tr>
<tr>
<td>Jill</td>
<td>$65,000</td>
<td>$6,500</td>
</tr>
<tr>
<td>Tracy</td>
<td>$30,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Chris</td>
<td>$20,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$485,000</td>
<td>$48,500</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
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<th>Contrib Rate</th>
<th>Integrated PS</th>
<th>Contrib Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$34,850</td>
<td>13.15%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Tiered Profit Sharing

<table>
<thead>
<tr>
<th>Age</th>
<th>Tiered Profit Sharing Contribution</th>
<th>Contrib Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>$26,500</td>
<td>10%</td>
</tr>
<tr>
<td>48</td>
<td>$3,500</td>
<td>3.33%</td>
</tr>
<tr>
<td>32</td>
<td>$2,167</td>
<td>3.33%</td>
</tr>
<tr>
<td>25</td>
<td>$1,000</td>
<td>3.33%</td>
</tr>
<tr>
<td>21</td>
<td>$667</td>
<td>3.33%</td>
</tr>
<tr>
<td></td>
<td>$33,834</td>
<td></td>
</tr>
</tbody>
</table>

**Owner’s Portion:** 54.6%  
**Cost Reduction:** $14,666
### DC PLANS

#### Profit Sharing Allocation: Tiered PS

- **Objective:** Maximize for 4 partners, give different rates to different groups based on job title
- **Owner’s comp is lower**

<table>
<thead>
<tr>
<th>Employee Type</th>
<th>Avg Age</th>
<th>Average Compensation</th>
<th>Total Contrib (rate) Basic P/S Or SEP</th>
<th>Total Contrib (rate) Tiered P/S</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Equity Partners</td>
<td>55</td>
<td>$265,000</td>
<td>$212,000 (20%)</td>
<td>$212,000 (20%)</td>
</tr>
<tr>
<td>3 Associates</td>
<td>42</td>
<td>150,000</td>
<td>90,000 (20%)</td>
<td>27,000 (8%)</td>
</tr>
<tr>
<td>3 Paralegals</td>
<td>36</td>
<td>80,000</td>
<td>48,000 (20%)</td>
<td>24,000 (10%)</td>
</tr>
<tr>
<td>3 Senior Staff</td>
<td>45</td>
<td>60,000</td>
<td>36,000 (20%)</td>
<td>12,600 (7%)</td>
</tr>
<tr>
<td>2 Junior Staff</td>
<td>29</td>
<td>45,000</td>
<td>18,000 (20%)</td>
<td>6,750 (7%)</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td></td>
<td>$600,000</td>
<td>$404,000</td>
<td>$282,350</td>
</tr>
</tbody>
</table>

**Owner’s Portion: 52%**

**Cost Savings: $121,650**

---

### DC PLANS

#### Profit Sharing Allocation: Tiered PS

- **Objective:** Maximize for owner, minimize for employees, and reduce compensation!

<table>
<thead>
<tr>
<th>Employee</th>
<th>Comp</th>
<th>10% Contribution</th>
<th>15% Contribution</th>
<th>20% Contribution</th>
<th>25% Contribution</th>
<th>30% Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janet (Owner)</td>
<td>$130K</td>
<td>$13,000</td>
<td>$13,650</td>
<td>$16,500</td>
<td>$21,000</td>
<td></td>
</tr>
<tr>
<td>Brian</td>
<td>$105K</td>
<td>$10,500</td>
<td>$10,500</td>
<td>$13,000</td>
<td>$16,250</td>
<td></td>
</tr>
<tr>
<td>Jill</td>
<td>$65K</td>
<td>$6,500</td>
<td>$6,500</td>
<td>$8,250</td>
<td>$10,625</td>
<td></td>
</tr>
<tr>
<td>Tracy</td>
<td>$30K</td>
<td>$3,000</td>
<td>$3,000</td>
<td>$3,825</td>
<td>$4,760</td>
<td></td>
</tr>
<tr>
<td>Chris</td>
<td>$20K</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$2,425</td>
<td>$2,930</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$350K</td>
<td>$35,000</td>
<td>$35,650</td>
<td></td>
<td></td>
<td>$35,650</td>
</tr>
</tbody>
</table>

**Owner’s Portion: 37.1%**

**38.3%**

**Cost Reduction: $11,000**

**Additional Total Deduction: $10,344**

**Additional Retirement Savings for Owner: $21,344**

---

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DC PLANS

401(k) Profit Sharing Plans

- 401(k) Plans are Profit Sharing Plans that allow salary deferral contributions by employees.
- Salary deferrals of up to $18,000 (2015, indexed)
- Catch-up contributions of $6,000 (2015, indexed) if Age 50 or older
- Plan may allow Roth deferrals
- Subject to additional non-discrimination testing on salary deferral amounts
- Plan can allow for additional profit sharing contributions and additional matching contributions

Safe Harbor 401(k) Profit Sharing Plans

- Eliminates testing on salary deferrals to allow maximum deferrals for owners.
- Employer is required to contribute:
  - 3% profit sharing to all eligible employees; or
  - Match equal to 100% of first 4% deferred; or
  - Match equal to 100% of first 3% deferred plus 50% of next 2%
- Additional profit sharing contributions allowed.
### Advantages of the Safe Harbor 3% NEC Plan

- **$16,000 increase (136%)** in contribution to Owner’s account
- Modest contribution to employees of $5,400 is predictable, may encourage participation
- Including Owner’s deferrals, Owner receives $27,750 of $33,150 outlay (84%)

### Contributions and Total for Owner

<table>
<thead>
<tr>
<th>Age</th>
<th>Salary</th>
<th>Deferral</th>
<th>Company</th>
<th>Total for Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner:</td>
<td>55</td>
<td>$125,000</td>
<td>$11,750</td>
<td>$11,750</td>
</tr>
<tr>
<td>6 Employees:</td>
<td></td>
<td>$180,000</td>
<td>n/a</td>
<td>$0</td>
</tr>
<tr>
<td>Totals:</td>
<td></td>
<td>$305,000</td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>Owner’s Percentage:</td>
<td>n/a</td>
<td></td>
<td></td>
<td>41%</td>
</tr>
</tbody>
</table>

### Deferral-Only 401(k) Plan

### Safe Harbor 401(k) With 3% NEC

<table>
<thead>
<tr>
<th>Contributions</th>
<th>Total for Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner</td>
<td>$24,000</td>
</tr>
<tr>
<td>n/a</td>
<td>$5,400</td>
</tr>
</tbody>
</table>

### Advantages of the Safe Harbor Match Plan

- **$17,250 increase (147%)** in contribution to Owner’s account
- Owner’s salary deferrals not limited based on employee contribution rates
- Matching contributions to employees ($7,200) encourages participation, increasing average deferral rate from 3% - 5% in this example.
- Matching contributions to employees could be as low as $0.
- Including Owner’s deferrals, Owner receives $29,000 of $36,200 outlay (80%)

### Contributions and Total for Owner

<table>
<thead>
<tr>
<th>Age</th>
<th>Salary</th>
<th>Deferral</th>
<th>Company</th>
<th>Total for Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner:</td>
<td>55</td>
<td>$125,000</td>
<td>$11,750</td>
<td>$11,750</td>
</tr>
<tr>
<td>6 Employees:</td>
<td></td>
<td>$180,000</td>
<td>$5,400</td>
<td>$0</td>
</tr>
<tr>
<td>Totals:</td>
<td></td>
<td>$305,000</td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>Owner’s Percentage:</td>
<td>n/a</td>
<td></td>
<td></td>
<td>41%</td>
</tr>
</tbody>
</table>
Advantages of the Tiered Plan

- $30,800 increase (109%) in contribution to Owner’s account
- Only a modest increase in contributions to employees ($3,600)
- Including Owner’s deferrals, Owner receives $59,000 of $68,000 (87%)

### Traditional SH 401(k) Plan

<table>
<thead>
<tr>
<th>Age</th>
<th>Salary</th>
<th>Deferral</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner: 55</td>
<td>$140,000</td>
<td>$24,000</td>
<td>$4,200</td>
</tr>
<tr>
<td>6 Employees:</td>
<td>$180,000</td>
<td>Employee option</td>
<td>$5,400</td>
</tr>
<tr>
<td>Totals:</td>
<td>$320,000</td>
<td></td>
<td>$9,600</td>
</tr>
</tbody>
</table>

Owner’s Percentage: 44%

### Tiered SH 401(k)

<table>
<thead>
<tr>
<th>Deferral</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>$24,000</td>
<td>$35,000</td>
</tr>
<tr>
<td>Employee option</td>
<td>$9,000</td>
</tr>
<tr>
<td>Totals</td>
<td>$44,000</td>
</tr>
</tbody>
</table>

Owner’s Percentage: 79%

### Owner-Only 401(k) Profit Sharing Plans

- Covers only owner or owner and spouse
- Assumes no other eligible employees
- Same limitations as other 401(k) plans
- Not considered an ERISA covered plan, so no Federal asset protection
DC PLANS

Owner-Only 401(k) Profit Sharing Plans

- With a 401(k), max contribution of $53,000 (plus $6,000 catchup) can be achieved with compensation of $140,000.
- A 401(k) is a better option than a SEP when an owner’s compensation is less than $212,000

<table>
<thead>
<tr>
<th>W-2 Compensation</th>
<th>401(k) Profit Sharing</th>
<th>401(k) Deferrals</th>
<th>Total Contribution</th>
<th>Compare to SEP</th>
<th>401(k) Increases Contribution by:</th>
</tr>
</thead>
<tbody>
<tr>
<td>$30,000</td>
<td>$7,500</td>
<td>$18,000</td>
<td>$25,500</td>
<td>$7,500</td>
<td>240%</td>
</tr>
<tr>
<td>$60,000</td>
<td>$15,000</td>
<td>$18,000</td>
<td>$33,000</td>
<td>$15,000</td>
<td>120%</td>
</tr>
<tr>
<td>$90,000</td>
<td>$22,500</td>
<td>$18,000</td>
<td>$40,500</td>
<td>$22,500</td>
<td>80%</td>
</tr>
<tr>
<td>$140,000</td>
<td>$35,000</td>
<td>$18,000</td>
<td>$53,000</td>
<td>$35,000</td>
<td>51%</td>
</tr>
<tr>
<td>$212,000</td>
<td>$53,000</td>
<td>$0</td>
<td>$53,000</td>
<td>$53,000</td>
<td>0%</td>
</tr>
</tbody>
</table>

DEFINED BENEFIT PENSION PLANS
Traditional and Cash Balance
DEFINED BENEFIT PENSION PLANS

DB Basics

- Defines the benefit to be paid to participant upon retirement based on a formula stated in plan document
- Normal form of payment is a single life annuity, but joint and survivor and lump sum options are available
- Employer funded
- Contributions determined by an actuary using required funding method. Generally, the contribution is the amount needed to fund the accrued benefits of the participants.
- Employer bears investment risk
- No individual participant accounts

Objectives: Small Business vs. Large Employer

- Small business owner’s primary objective is to fund large benefit for self, minimize funding for employees
  - Owner gets lion’s share of benefits, therefore wants to fund the plan as much as possible
  - Happy with steady, moderate investment return

- Large DB plan sponsor’s primary objective is to provide a meaningful benefit to employees with minimal funding
  - Shareholders wish to minimize pension liability and annual funding requirement
  - Target higher investment return to help fund the plan
DEFINED BENEFIT PENSION PLANS

Benefit Limit Drives Contribution Limit

- Annual Benefit at retirement is limited to the lesser of:
  - 100% of the highest 3-year average compensation, OR
  - $210,000 (2015)*
- Max lump sum equivalent is $2.4 million*
- Annual contribution can be as much as $200,000 or even $300,000 in some cases**

* Assumes 10 years of plan participation.
** Maximum contribution may be lower depending on age and compensation.

DEFINED BENEFIT PENSION PLANS

When Are DB Plans Effective?

- Owner is age 42 or older
- Owner wants to save more than $53,000 annually over several years for retirement
- Owner's compensation is higher than most employees (preferably $265,000+)
- Business has fairly stable income
- Owner does not mind relatively fixed contributions each year
DEFINED BENEFIT PENSION PLANS

DB Rules... The Fine Print

• DB Plans should be maintained and funded for a minimum of 5 years
• Must be adopted prior to end of employer’s fiscal year
• Contributions must be deposited prior to the business tax-filing deadline. If extended, no later than 8½ months after year end

DEFINED BENEFIT PENSION PLANS

More Flexible Than You May Think

• If contribution objectives change, the plan may be amended to meet the new objectives
• Must be done on a timely basis
• Can be combined with 401(k) plans for increased deductions
### Defined Benefit Pension Plans

#### DB Plan Paired with 401(k) Plan

Examples of Defined Benefit & 401(k) Plan Contributions:

<table>
<thead>
<tr>
<th>Age</th>
<th>W-2 Wages</th>
<th>DB Contribution</th>
<th>Add 401(k) Def + 6% PS</th>
<th>Total Contribution</th>
<th>Compare to SEP</th>
<th>DB/401(k) Advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>$150,000</td>
<td>$87,646</td>
<td>$27,000</td>
<td>$114,646</td>
<td>$37,500</td>
<td>+$77,146</td>
</tr>
<tr>
<td>50</td>
<td>$260,000</td>
<td>$160,895</td>
<td>$39,600</td>
<td>$200,495</td>
<td>$53,000</td>
<td>+$147,495</td>
</tr>
<tr>
<td>60</td>
<td>$150,000</td>
<td>$226,053</td>
<td>$33,000</td>
<td>$259,053</td>
<td>$37,500</td>
<td>+$221,553</td>
</tr>
</tbody>
</table>

Examples used for illustrative purposes only.

#### Defined Benefit Pension Plans

First Year Deductible Contribution

The table below provides the max contribution amounts allowed for owners of various ages. The table assumes a corporation with owner’s **W-2 compensation of $210,000** and no prior DB Plan.

<table>
<thead>
<tr>
<th>NRA</th>
<th>Age 45</th>
<th>Age 48</th>
<th>Age 49</th>
<th>Age 50</th>
<th>Age 51</th>
<th>Age 52</th>
<th>Age 53</th>
<th>Age 54</th>
</tr>
</thead>
<tbody>
<tr>
<td>62 &amp; 5P</td>
<td>$121,206</td>
<td>$138,595</td>
<td>$144,929</td>
<td>$151,552</td>
<td>$158,478</td>
<td>$165,720</td>
<td>$173,294</td>
<td>$181,213</td>
</tr>
<tr>
<td>65 &amp; 5P</td>
<td>$81,293</td>
<td>$113,086</td>
<td>$118,254</td>
<td>$123,658</td>
<td>$129,309</td>
<td>$135,219</td>
<td>$141,398</td>
<td>$147,860</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NRA</th>
<th>Age 55</th>
<th>Age 56</th>
<th>Age 57</th>
<th>Age 58</th>
<th>Age 59</th>
<th>Age 60</th>
<th>Age 61</th>
<th>Age 62</th>
</tr>
</thead>
<tbody>
<tr>
<td>62 &amp; 5P</td>
<td>$189,495</td>
<td>$198,154</td>
<td>$207,210</td>
<td>$246,528</td>
<td>$241,113</td>
<td>$235,620</td>
<td>$230,011</td>
<td>$224,305</td>
</tr>
<tr>
<td>65 &amp; 5P</td>
<td>$154,617</td>
<td>$161,683</td>
<td>$169,072</td>
<td>$176,299</td>
<td>$184,879</td>
<td>$193,328</td>
<td>$230,011</td>
<td>$224,305</td>
</tr>
</tbody>
</table>

This table does not take into account fees or expenses associated with investments.

Examples used for illustrative purposes only.
DEFINED BENEFIT PENSION PLANS

Cash Balance DB Plans

- Cash Balance Plans are a type of defined benefit plan
- Participant’s benefit is defined as a hypothetical account balance similar to a defined contribution plan
- Balance grows each year based on:
  - Pay credit (percentage of compensation), PLUS
  - Interest credit (rate defined by plan)
- Maximum lump sum benefit at normal retirement age is the same as a defined benefit plan (approximately $2.4 million*)

*Assumes NRA 65, 10 years of participation, and maximum accrued benefit

DEFINED BENEFIT PENSION PLANS

Cash Balance DB Plans

- Assets of the Cash Balance Plan are directed by the Plan Trustees, not Participants
  - There are no actual participant-directed investment accounts like DC plans
- Contributions are generally calculated using current year income, not the highest consecutive 3-year average
- Cash Balance Plans are more appropriate for businesses with multiple owners because contributions can be the same even though their ages may differ
- Many employers prefer CBDB plans over traditional DB plans because it’s easier to communicate the value of a lump sum balance than a future annuity
DEFINED BENEFIT PENSION PLANS

Cash Balance DB Plan – Paired with 401(k) PS Plan

- Can combine CBDB Plan with 401(k) PS Plan
- Combo plans maximize contributions for owners and minimize contributions to the employees
- Adding a Cash Balance Plan to a 401(k) may increase owner’s savings by $100,000+ with only marginal increases in contributions for the non-owner employees
- Existing Safe Harbor 401(k) Plan sponsors who are older than most of their employees and who earn $200,000 or more should consider a combo plan
- Participants can direct the investments of the 401(k) portion of the plan assets

DEFINED BENEFIT PENSION PLANS

Pension Benefit Guaranty Corporation

- Quasi-governmental corporation within the DOL established to oversee the administration of Defined Benefit Plans
- Insures against plan insolvency
- 2015 PBGC Insurance Premium = $57 per participant
- Exemptions:
  - Professional service groups that have always had 25 or fewer active plan participants
  - Plans covering only substantial owners
### Non PBGC

<table>
<thead>
<tr>
<th>Age</th>
<th>W-2 Salary</th>
<th>Employee Deferral</th>
<th>Tiered/Safe Harbor * Balance</th>
<th>Cash Balance Contribution</th>
<th>Percentage of Total of Company Contribution</th>
<th>Total Company Contribution (exclude employee deferrals)</th>
<th>Total of Total Contribution</th>
<th>Percent of Total of Total Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner 1</td>
<td>52</td>
<td>$260,000</td>
<td>$23,000</td>
<td>$15,210</td>
<td>$174,121</td>
<td>$189,331</td>
<td>98.7%</td>
<td>$212,331</td>
</tr>
<tr>
<td>Employee 1</td>
<td>29</td>
<td>$25,000</td>
<td>$500</td>
<td>$1,875</td>
<td>$2,422</td>
<td>1.3%</td>
<td>$2,422</td>
<td>1.13%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$285,000</td>
<td></td>
<td>$17,085</td>
<td>$174,668</td>
<td>$191,753</td>
<td></td>
<td>$214,753</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

*Includes Safe Harbor 3% Non-Elective Contribution.

**Assumes 5% rate of return on all 401(k) assets.

***First year Cash Balance contributions are less than the Theoretical Account Balances. Contributions may be equalized in second plan year.

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Examples used for illustrative purposes only

---

### PBGC

<table>
<thead>
<tr>
<th>Age</th>
<th>W-2 Salary</th>
<th>Employee Deferral</th>
<th>Tiered/Safe Harbor * Balance</th>
<th>Cash Balance Contribution</th>
<th>Percentage of Total of Company Contribution</th>
<th>Total Company Contribution (exclude employee deferrals)</th>
<th>Total of Total Contribution</th>
<th>Percent of Total of Total Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner 1</td>
<td>52</td>
<td>$260,000</td>
<td>$23,000</td>
<td>$34,500</td>
<td>$174,121</td>
<td>$208,621</td>
<td>98.7%</td>
<td>$231,621</td>
</tr>
<tr>
<td>Employee 1</td>
<td>29</td>
<td>$25,000</td>
<td>$500</td>
<td>$2,125</td>
<td>$547</td>
<td>$2,672</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$285,000</td>
<td></td>
<td>$36,625</td>
<td>$174,668</td>
<td>$211,293</td>
<td></td>
<td>$234,293</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

*Includes Safe Harbor 3% Non-Elective Contribution.

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## CASH BALANCE COMBO EXAMPLE 2 – NON PBGC COVERED

This illustration is hypothetical and not intended to reflect any specific investment or product; and does not take into account any relevant fees or expenses associated with investment products.

### Results Summary

<table>
<thead>
<tr>
<th>Age</th>
<th>W-2 Salary</th>
<th>Employee Deferral</th>
<th>Tiered/Safe Harbor*</th>
<th>Cash Balance Contribution***</th>
<th>Total Company Contribution</th>
<th>Percentage of Total Company Contribution</th>
<th>Total for Owners:</th>
<th>Total Contribution:</th>
<th>Percentage of Total Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner 1</td>
<td>50</td>
<td>$260,000</td>
<td>$23,000</td>
<td>$12,350</td>
<td>$156,699</td>
<td>$169,049</td>
<td>40.6%</td>
<td>$192,049</td>
<td>41.52%</td>
</tr>
<tr>
<td>Owner 2</td>
<td>55</td>
<td>$260,000</td>
<td>$23,000</td>
<td>$12,350</td>
<td>$199,998</td>
<td>$212,348</td>
<td>51.0%</td>
<td>$235,348</td>
<td>50.98%</td>
</tr>
</tbody>
</table>

**Notes:**
- *Includes Safe Harbor 3% Non-Elective Contribution.
- **Assumes 5% rate of return on all 401(k) assets.
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### Results Summary

<table>
<thead>
<tr>
<th>Age</th>
<th>W-2 Salary</th>
<th>Employee Deferral</th>
<th>Tiered/Safe Harbor*</th>
<th>Cash Balance Contribution***</th>
<th>Total Company Contribution</th>
<th>Percentage of Total Company Contribution</th>
<th>Total for Employees:</th>
<th>Total Contribution:</th>
<th>Percentage of Total Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner 1</td>
<td>50</td>
<td>$260,000</td>
<td>$23,000</td>
<td>$34,500</td>
<td>$156,735</td>
<td>$191,235</td>
<td>41.5%</td>
<td>$214,235</td>
<td>42.26%</td>
</tr>
<tr>
<td>Owner 2</td>
<td>55</td>
<td>$260,000</td>
<td>$23,000</td>
<td>$34,500</td>
<td>$200,040</td>
<td>$234,540</td>
<td>50.9%</td>
<td>$257,540</td>
<td>50.81%</td>
</tr>
</tbody>
</table>

**Notes:**
- *Includes Safe Harbor 3% Non-Elective Contribution.
- **Assumes 5% rate of return on all 401(k) assets.
- ***First year Cash Balance contributions are less than the Theoretical Account Balances. Contributions may be equalized in second plan year.

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CASH BALANCE COMBO
EXAMPLE 3 – NON PBGC COVERED

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CASH BALANCE COMBO
EXAMPLE 3 – PBGC COVERED

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SELECTING A PLAN & PROVIDER

Plan Design Analysis

• Talk to a retirement plan design expert who will take the time to walk through various plan design options
• Provide basic employee census and company information
• Get contribution and cost estimates for a variety of plan types

• Tip: If you or your client will complete TCI’s Retirement Plan Questionnaire, we’ll do the analysis and illustrations for you
# SELECTING A PLAN & PROVIDER: FULL-SERVICE OR UN-BUNDLED?

<table>
<thead>
<tr>
<th>SERVICE INCLUDED</th>
<th>Bundled</th>
<th>Typical Un-bundled (Piecemeal) Arrangement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-Fiduciary Investment Sales</strong></td>
<td>NO</td>
<td>Broker = YES</td>
</tr>
<tr>
<td></td>
<td></td>
<td>RIA = Sometimes</td>
</tr>
<tr>
<td><strong>Fiduciary Investment Advice</strong></td>
<td>YES</td>
<td>SOME</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Outside fiduciary consultant</td>
</tr>
<tr>
<td><strong>Fiduciary Investment Management</strong></td>
<td>YES</td>
<td>SOME</td>
</tr>
<tr>
<td><strong>Trustee</strong></td>
<td>YES</td>
<td>TIMES</td>
</tr>
<tr>
<td><strong>Plan Design/Consulting</strong></td>
<td>YES</td>
<td>USUALLY</td>
</tr>
<tr>
<td><strong>Plan Documents</strong></td>
<td>YES</td>
<td>LIMITED PROTOTYPES</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Limited PROTOTYPES</td>
</tr>
<tr>
<td><strong>Administration</strong></td>
<td>YES</td>
<td></td>
</tr>
<tr>
<td><strong>Compliance, Document Interpretation</strong></td>
<td>YES</td>
<td></td>
</tr>
<tr>
<td><strong>Recordkeeping, Transaction Processing</strong></td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td><strong>Participant Notices, Communications</strong></td>
<td>YES</td>
<td>SOME</td>
</tr>
<tr>
<td><strong>Participant Education, Guidance</strong></td>
<td>YES</td>
<td>SOME</td>
</tr>
<tr>
<td><strong>Participant Investment Advice, Financial Planning</strong></td>
<td>YES</td>
<td>SOME</td>
</tr>
<tr>
<td><strong>Annual/Quarterly Meetings with Sponsor</strong></td>
<td>YES</td>
<td>SOME RARELY</td>
</tr>
<tr>
<td><strong>Comprehensive, Audit-Ready, Valuation/Reports</strong></td>
<td>YES</td>
<td>RARELY</td>
</tr>
<tr>
<td><strong>Government reporting</strong></td>
<td>YES</td>
<td></td>
</tr>
</tbody>
</table>

## RETIREMENT PLAN OPPORTUNITIES

**Trust Company of Illinois**

### Questions?

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Benetech, Inc. provided a few of the examples and some of the information contained herein.