

CASE STUDY: 401(k) New Comparability Profit Sharing Plan

Client Profile

Client: Business to business sales
Age of Owner: 60
Age of Spouse: 40
Tax Structure: S-Corporation
Number of Non-Owner HCEs: 0

Type of Business: Food Distribution
Marital Status: Married
Does spouse provide services to business? Yes
Number of Owner HCEs: 2 (owner and spouse)
Rank-and-File Employees: 11

Net Business Income: \$400,000
W-2 Compensation (Owner): \$250,000
W-2 Compensation (Spouse): \$54,000
Sub-S Distribution: \$96,000

Background: Client approached his advisor to review the efficiency of the plan currently sponsored by the business. The owner was interested in continuing to provide a level of benefit to all of their employees while making sure that his personal savings opportunity is maximized.

Current Plan

Type: Profit Sharing Plan (funded by company contributions only)
Owner Funding: \$50,000 (Owner), \$9,078 (Spouse)
Employee Funding: \$71,444 (52% of total plan funding)

Proposed Plan

The company maintained an Integrated Profit Sharing plan which allocated a base contribution to all eligible participants and an additional contribution to participants with compensation in excess of the Social Security Taxable Wage Base (2012: \$110,100). While this design does favor higher paid employees, the existing plan was not optimized to meet this client's needs in his specific situation. Because the company employed a number of highly-paid sales managers, employer contribution costs for the non-owner employees were very high. We recommended amending the Profit Sharing Plan to include a 3% Non-Elective Safe Harbor 401(k) component and use multiple tiers approach (new comparability) in providing contributions to plan participants. The new profit sharing allocation method allows the owner to maximize his contributions with a significantly reduced employee cost. If desired, the company is now able to provide additional discretionary profit contributions (on top of the required baseline minimum) to a select group of employees (sales managers who have direct impact on the bottom line of the business, for instance) to recognize their unique contribution. Compare the new approach to the old Integrated Plan where all participants received a uniform allocation.

Owner funding increased to \$74,120 (\$17,000 deferral to owner and spouse, \$5,000 catch-up to owner, \$33,000 Profit Sharing contribution to owner and \$1,620 contribution to the spouse), while the rank-and-file cost were reduced by \$52,616. The overall cost/benefit ratio for this plan improved by 32%. The client is contemplating establishment of a Defined Benefit Plan to further increase the annual savings in future years.

Owner Funding

Increased by \$9,542 (from \$64,578 to \$74,120), while the rank-and-file costs were kept at about \$18,828 (compare to the old design where the company would have to provide a contribution of \$71,444 when owner and spouse maximized their funding). Clients were allocated 80% of the total plan funding realizing about \$20,000 of tax savings net of employee costs.

Proposed Plan

Type: 401(k) Plan with a 3% Non-elective Safe Harbor and a New Comparability Profit Sharing
Owner Funding: \$55,500 (Owner), \$18,620 (Spouse) – 80% of total
Employee Funding: \$18,828 – 20% of total
Tax Savings (Net of Employee Costs): \$20,041

**Interested in exploring potential benefits of this design for your clients and prospects?
Reach out to your First Allied Retirement Services SMEs:**

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Sample Company

Name	Date of		Plan Comp
	Birth	Hire	
Owner 1	3/8/1952	1/1/2000	\$250,000
Spouse 1	5/16/1972	6/1/2009	\$54,000
Highly Compensated Employees (HCE)			
Employee 1	6/24/1961	10/1/1998	\$100,000
Employee 2	10/14/1969	4/1/2001	\$36,000
Employee 3	10/1/1971	10/1/2004	\$82,000
Employee 4	3/4/1967	7/1/2007	\$47,000
Employee 5	11/25/1979	9/1/2009	\$30,000
Employee 6	9/18/1980	3/1/2010	\$40,000
Employee 7*	11/20/1954	1/1/2011	\$10,000
Employee 8*	8/14/1956	1/1/2011	\$10,000
Employee 9	5/17/1961	11/1/2009	\$90,000
Employee 10*	12/30/1983	1/1/2011	\$48,000
Employee 11*	4/13/1974	6/1/2011	\$40,000
Non-Highly Compensated Employees (NHCE)			

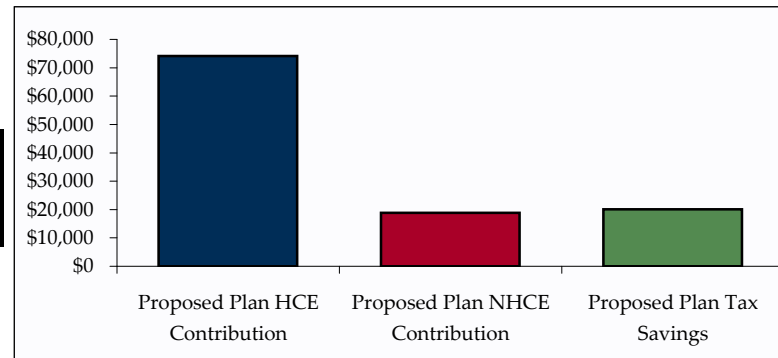
*Does not meet minimum service requirements

Plan Comparison:

Proposed Plan HCE Contribution	\$74,120	80%
Proposed Plan NHCE Contribution	\$18,828	20%
Proposed Plan Tax Savings	\$20,041	

Qualified Plan Proposal

401(k) Cross-Tested Profit Sharing Plan				
Proposed Plan				
Salary Deferral	Catch-Up	3% Safe Harbor	Profit Sharing	Total \$
\$17,000	\$5,500	\$0	\$33,000	\$55,500
\$17,000	\$0	\$0	\$1,620	\$18,620
\$34,000	\$5,500	\$0	\$34,620	\$74,120
\$0	\$0	\$3,000	\$1,430	\$4,430
\$0	\$0	\$1,080	\$515	\$1,595
\$0	\$0	\$2,460	\$1,173	\$3,633
\$0	\$0	\$1,410	\$672	\$2,082
\$0	\$0	\$900	\$429	\$1,329
\$0	\$0	\$1,200	\$572	\$1,772
\$0	\$0	\$0	\$0	\$0
\$0	\$0	\$0	\$0	\$0
\$0	\$0	\$2,700	\$1,287	\$3,987
\$0	\$0	\$0	\$0	\$0
\$0	\$0	\$0	\$0	\$0
\$0	\$0	\$12,750	\$6,078	\$18,828





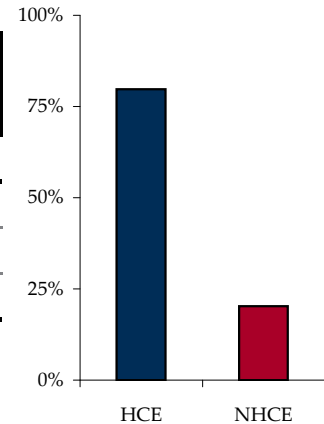
Proposed 401(k) Cross-Tested Profit Sharing Plan as of 12/31/2012

Implementation Advantages

1: Estimated Plan Funding Summary

Highly Compensated Employees (HCE)

	Salary Deferral	Catch-Up	3% Safe Harbor	Profit Sharing	Total Contribution	% of Total	Individual Tax Savings
Owner 1	\$17,000	\$5,500	\$0	\$33,000	\$55,500	59.71%	\$15,006
Spouse 1	\$17,000	\$0	\$0	\$1,620	\$18,620	20.03%	\$5,034
HCE Totals	\$34,000	\$5,500	\$0	\$34,620	\$74,120	79.74%	
Non-Highly Compensated Employees (NHCE)	\$0	\$0	\$12,750	\$6,078	\$18,828	20.26%	
Total Plan Funding					\$92,948	100.00%	



2: Estimated Tax Savings v. Funding Cost

Total Plan Funding	Tax Rates	Gross Tax Savings	Medicare Impact	Employer Contribution to Rank & File	Net Tax Savings
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Total Plan Funding (less rank-and-file deferrals) **\$92,948**

Tax Rates

Federal		35.00%
State (Median Rate)	CA	5.15%
Medicare		2.90%
Combined Tax Rate		43.05%

Gross Tax Savings **\$40,014**

Less Medicare Tax of 2.9% on Owner Deferral **\$1,146**

Less Contribution for rank-and-file Employees **\$18,828**

Net Tax Savings **\$20,041**

3: Additional Advantages Inherent to Qualified Plans:

- Tax treatment diversification available through Roth 401(k) feature
- Payroll tax: employer contributions not subject to payroll tax
- ERISA protection for plan assets from judgment creditors
- Employer contributions deductible to business
- Tax-deferral on contributions and earnings
- Opportunity for participants to defer a portion of salary in a tax-advantaged vehicle for retirement
- Ability to transfer plan assets to another plan upon termination of current plan or employment
- Maximize tax-advantaged funding with IRS Letter of Determination regarding tax benefits
- Accessibility of plan assets via loans, hardship, and in-service distributions
- Effective Employee Retention Tool