

# CASE STUDY: New Comparability Profit Sharing Plan

## Client Profile

Client: Professional Services  
Age of Owner 1: 41  
Age of Owner 2: 53  
Tax Structure: C-Corporation

Type of Business: Certified Public Accountant  
Number of Owner HCEs: 2  
Rank-and-File Employees: 4

Net Business Income: \$625,000  
W-2 Compensation (Owner 1): \$250,000  
W-2 Compensation (Owner 1): \$250,000

## Current Plan

Type: Money Purchase Pension Plan (funded by company contributions)  
Owner Funding: \$50,000 (Owner 1), \$50,000 (Owner 2)  
Employee Funding: \$32,000 (24% of total plan funding)  
Tax Savings Net of Employee Costs: \$8,932

Background: The plan, sponsored by the business since 1997 was reviewed in the course of an annual review meeting to determine its efficiency and possible alternatives.

## Proposed Plan

The firm maintained a combination plan which consisted of a Money Purchase Pension Plan (MPP) and a Profit Sharing Plan (PSP). This approach represented an outdated, yet still encountered in practice, plan design. Before 2002, MPPs were regularly employed by well-advised small business owners as they afforded an increase in savings beyond the 15% maximum contribution cap imposed on Profit Sharing Plans. A 10% contribution to a MPP in a combination plan allowed a plan sponsor to make a deductible contribution of up to 25% of compensation. Despite the advantages, today, this "combo plan" approach leaves much to be desired: (1) *Limited flexibility*: Due to the mandatory nature of the MPP funding, contributions are required even when cash flow is tight; (2) *Increased administrative burden*: These plans mandate separate accounting for their assets and demand compliance with a unique set of participant notification and ERISA reporting requirements; (3) *Higher fees*: A separate plan typically requires additional professional fees. The need for the combo plan approach diminished in 2001, when the U.S. Congress enacted the EGTRRA. One of the key provisions of the Act increased the deduction limit for Profit Sharing Plans from 15% to 25% of compensation. Now you can make contributions at levels previously possible only in a combination of plans in one plan, a Profit Sharing Plan, without losing flexibility, wasting valuable time, or incurring additional expense.

We recommended termination of the MPP with a subsequent rollover of account balances to the PSP to preserve the asset protection attributes inherent to ERISA plans. We further suggested amending the Profit Sharing contribution allocation methodology from uniform percent of pay to new comparability (cross-tested method), placing each participant in their own allocation group. The new method allows the owners to tailor their contributions as needed, an opportunity previously not available, and reduces the required employee contribution from 20% to 5%. This option is available under Section 401(a)(4) of the Internal Revenue Code which permits testing contributions as if they were benefits under a pension plan and thereby show that they are non-discriminatory toward the non-highly compensated employees. The company is still able to fund employee benefits at the current level but is no longer required to do so when maximizing owner contribution. The new approach combines ability to tailor contributions with flexibility and efficiency previously not experienced.

## Owner Funding

Remained at the desired \$50,000 level per owner; the mandatory rank-and-file costs were reduced by \$24,000 to \$8,000. Clients' allocation increased to 93% of the total plan funding increasing the tax savings net of employee costs to about \$33,000.

**Proposed Plan Type:** New Comparability Profit Sharing Plan **Owner Funding:** \$50,000 (Owner 1), \$50,000 (Owner 2) – 93% of total **Employee Funding:** \$8,000 – 20% of total **Tax Savings (Net of Employee Costs):** \$33,932

**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 A	4/20/1971	1/1/2010	\$250,000
Owner B	3/14/1959	1/1/2010	\$250,000
<b>Highly Compensated Employees (HCE)</b>			
Employee 1	3/24/1984	6/8/2010	\$25,000
Employee 2	4/17/1981	3/1/2010	\$35,000
Employee 3	5/22/1979	3/1/2010	\$45,000
Employee 4	7/3/1967	1/3/2010	\$55,000
<b>Non-Highly Compensated Employees (NHCE)</b>			

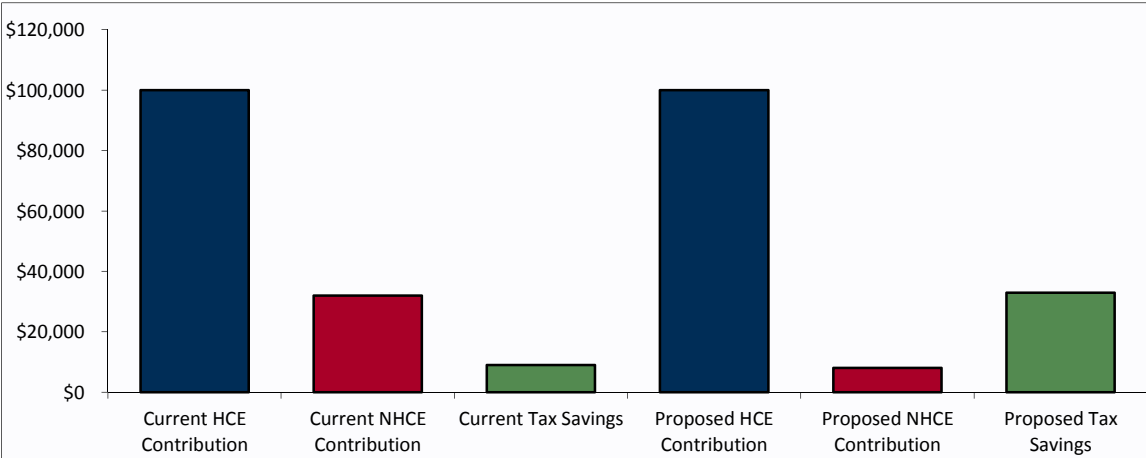
**Qualified Plan Proposal**

Money Purchase Plan/Profit Sharing Plan		
Current		
Money Purchase	Profit Sharing	Total \$
\$37,500	\$12,500	\$50,000
\$37,500	\$12,500	\$50,000
<b>\$75,000</b>	<b>\$25,000</b>	<b>\$100,000</b>
\$3,750	\$1,250	\$5,000
\$5,250	\$1,750	\$7,000
\$6,750	\$2,250	\$9,000
\$8,250	\$2,750	\$11,000
<b>\$24,000</b>	<b>\$8,000</b>	<b>\$32,000</b>

New Comparability Profit Sharing Plan	
Proposed	
Total \$	
\$50,000	
\$50,000	
<b>\$100,000</b>	
\$1,250	
\$1,750	
\$2,250	
\$2,750	
<b>\$8,000</b>	

**Plan Comparison:**

Current HCE Contribution	\$100,000	76%
Current NHCE Contribution	\$32,000	24%
Current Tax Savings	\$8,932	
Proposed HCE Contribution	\$100,000	93%
Proposed NHCE Contribution	\$8,000	7%
Proposed Tax Savings	\$32,932	

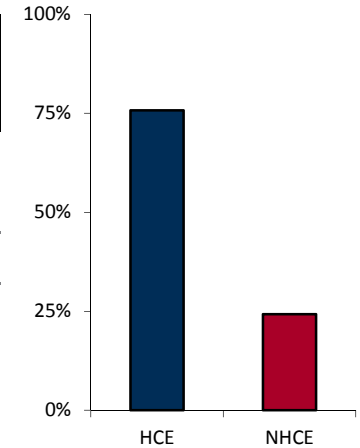


## Current Money Purchase Plan/Profit Sharing Plan as of 12/31/2012

### Implementation Advantages

#### 1: Estimated Plan Funding Summary

	Money Purchase	Profit Sharing	Total Contribution	% of Total	Individual Tax Savings
<b>Highly Compensated Employees (HCE)</b>					
Owner A	\$37,500	\$12,500	\$50,000	37.88%	\$4,466
Owner B	\$37,500	\$12,500	\$50,000	37.88%	\$4,466
<b>HCE Totals</b>	<b>\$75,000</b>	<b>\$25,000</b>	<b>\$100,000</b>	<b>75.76%</b>	
<b>Non-Highly Compensated Employees (NHCE)</b>	\$24,000	\$8,000	\$32,000	24.24%	
<b>Total Plan Funding</b>			<b>\$132,000</b>	<b>100.00%</b>	



#### 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
<b>Total Plan Funding (less rank-and-file deferrals)</b>	<b>\$108,000</b>					
<b>Tax Rates</b>						
Federal			35.00%			
State (Median Rate)		WA	0.00%			
Medicare			2.90%			
<b>Combined Tax Rate</b>			<b>37.90%</b>			
<b>Gross Tax Savings</b>			<b>\$40,932</b>			
<b>Less Medicare Tax of 2.9% on Owner Deferral</b>				<b>\$0</b>		
<b>Less Contribution for rank-and-file Employees</b>					<b>\$32,000</b>	
<b>Net Tax Savings</b>						<b>\$8,932</b>

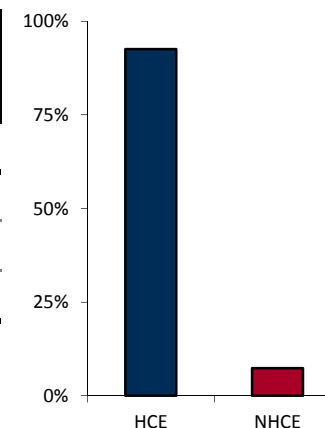
## Proposed New Comparability Profit Sharing Plan as of 12/31/2012

### Implementation Advantages

#### 1: Estimated Plan Funding Summary

##### Highly Compensated Employees (HCE)

	Total Contribution	% of Total	Individual Tax Savings
Owner A	\$50,000	46.30%	\$16,466
Owner B	\$50,000	46.30%	\$16,466
<b>HCE Totals</b>	<b>\$100,000</b>	<b>92.59%</b>	
<b>Non-Highly Compensated Employees (NHCE)</b>	<b>\$8,000</b>	<b>7.41%</b>	
<b>Total Plan Funding</b>	<b>\$108,000</b>	<b>100.00%</b>	



#### 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
<b>Total Plan Funding (less rank-and-file deferrals)</b>	<b>\$108,000</b>					
<b>Tax Rates</b>						
Federal		35.00%				
State (Median Rate)		<b>WA</b> 0.00%				
Medicare		2.90%				
<b>Combined Tax Rate</b>		<b>37.90%</b>				
<b>Gross Tax Savings</b>			<b>\$40,932</b>			
<b>Less Medicare Tax of 2.9% on Owner Deferral</b>				<b>\$0</b>		
<b>Less Contribution for rank-and-file Employees</b>					<b>\$8,000</b>	
<b>Net Tax Savings</b>						<b>\$32,932</b>

#### 3: Additional Advantages Inherent to Qualified Plans:

- 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
- 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