

CASE STUDY: 401(k) Profit Sharing with a Cash Balance Plan

Client Profile

Client: Veterinarian in TX
Age of Owner: 65
Age of Spouse: 64
Tax Structure: S-Corporation
Number of Non-Owner HCEs: 0

Type of Business: Veterinary Medicine
Marital Status: Married
Does spouse provide services to business? Yes, back office support.
Number of Owner HCEs: 2 (owner and spouse)
Rank-and-File Employees: 8

Net Business Income: \$500,000
W-2 Compensation (Owner): \$230,000
W-2 Compensation (Spouse): \$24,000
Sub-S Distribution: \$246,000

Current Plan

Type: SEP IRA (funded by company contributions only)
Owner Funding: \$55,217(70%)
Employee Funding: \$24,178 (30%)

Background: Client approached his advisor to identify a retirement plan design that would enable him to maximize his retirement plan savings in light of nearing retirement. Client's existing SEP IRA plan limited the owners' funding to \$55,217 with the employee funding obligation of \$24,178; the cost which virtually stripped any of the tax advantages of the plan.

Proposed Plan

The company maintained a SEP IRA which allocated a uniform percentage of compensation to all eligible participants. The existing plan was not optimized to meet this client's needs. Because the company employed a number of non-highly compensated employees, the contribution costs under the SEP arrangement were unnecessarily high. We recommended a General Tested Cash Balance Plan layered on top of a 401(k) Cross Tested Profit Sharing Plan. The combined non-discrimination testing of two plans coupled with a higher deductible funding opportunity of Cash Balance Plans allowed the client to reach his desired level of funding with a reasonable employee funding cost.

Owner funding increased to \$283,796, while the rank-and-file cost were reduced by \$15,464 to \$8,714. The overall cost/benefit ratio for this plan improved by 27%.

Owner Funding

Increased by \$228,579 (from \$55,217 to \$283,796), while the rank-and-file costs were reduced to \$8,714. Clients were allocated 97% of the total plan funding realizing about \$100,842 of tax savings net of employee costs.

Proposed Plan

Type: 401(k) Cross-tested Profit sharing Plan with a General-tested Cash Balance Defend Benefit Plan
Owner Funding: \$259,520 (Owner), \$24,276 (Spouse) – 97% of total
Employee Funding: \$8,714 – 3% of total
Tax Savings (Net of Employee Costs): \$100,842

**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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ESTIMATE
FOR PLANNING PURPOSES ONLY

Veterinary Clinic

Qualified Plan Proposal

Name	Date of		Plan Comp
	Birth	Hire	
Owner	4/25/1947	1/1/2000	\$230,000
Spouse*	8/16/1948	1/1/2000	\$24,000
Highly Compensated Employees (HCE)			
Employee 1	7/24/1985	1/1/2007	\$13,510
Employee 2	10/3/1981	9/1/2003	\$15,500
Employee 3	8/28/1984	8/2/2005	\$13,000
Employee 4	3/13/1985	5/1/2006	\$16,500
Employee 5	5/3/1958	2/11/2002	\$31,000
Employee 6**	1/15/1982	1/21/2008	\$13,211
Employee 7**	5/27/1981	12/14/2007	\$7,500
Employee 8**	10/19/1986	2/25/2007	\$1,000
Non-Highly Compensated Employees (NHCE)			

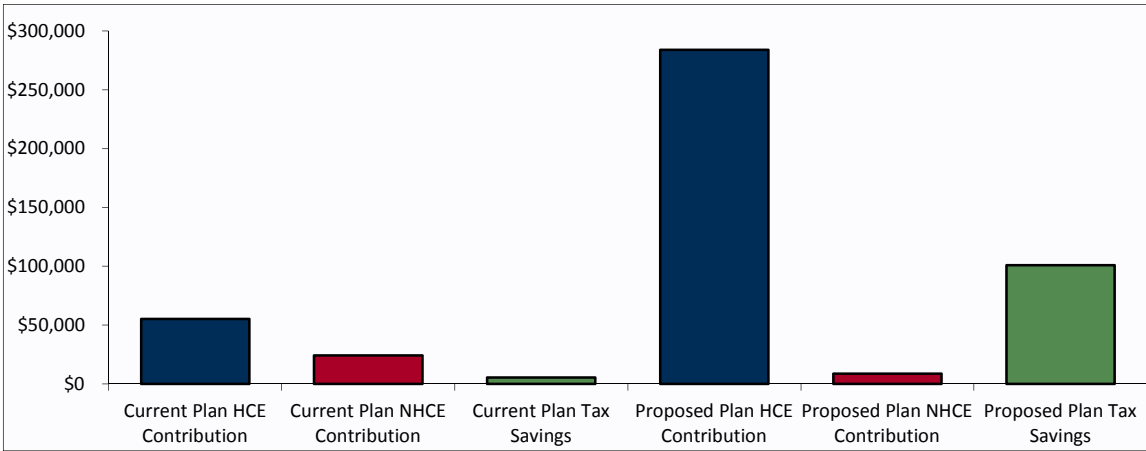
SEP IRA Current Plan
Total \$
\$50,000
\$5,217
\$55,217
\$2,937
\$3,370
\$2,826
\$3,587
\$6,739
\$2,872
\$1,630
\$217
\$24,178

General Tested Cash Balance Plan with a 401(k) Cross-Tested PSP					
Proposed Plan					
Salary Deferral	Catch-Up	3% Safe Harbor	Profit Sharing	Cash Balance Plan Funding	Total \$
\$17,000	\$5,500	\$6,900	\$10,120	\$220,000	\$259,520
\$17,000	\$5,500	\$720	\$1,056	\$0	\$24,276
\$34,000	\$11,000	\$7,620	\$11,176	\$220,000	\$283,796
\$0	\$0	\$405	\$608	\$400	\$1,413
\$0	\$0	\$465	\$698	\$400	\$1,563
\$0	\$0	\$390	\$585	\$400	\$1,375
\$0	\$0	\$495	\$743	\$400	\$1,638
\$0	\$0	\$930	\$1,395	\$400	\$2,725
\$0	\$0	\$0	\$0	\$0	\$0
\$0	\$0	\$0	\$0	\$0	\$0
\$0	\$0	\$0	\$0	\$0	\$0
\$0	\$0	\$2,685	\$4,029	\$2,000	\$8,714

*Excluded from the Cash Balance Plan
**Does not meet service requirements

Plan Comparison:

Current Plan HCE Contribution	\$55,217	70%
Current Plan NHCE Contribution	\$24,178	30%
Current Plan Tax Savings	\$5,594	
Proposed Plan HCE Contribution	\$283,796	97%
Proposed Plan NHCE Contribution	\$8,714	3%
Proposed Plan Tax Savings	\$100,842	

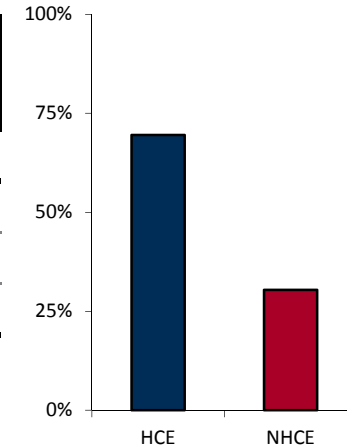


Current SEP IRA as of 12/31/2012

Implementation Advantages

1: Estimated Plan Funding Summary

	Total Contribution	% of Total	Individual Tax Savings
Highly Compensated Employees (HCE)			
Owner	\$50,000	62.98%	\$5,065
Spouse*	\$5,217	6.57%	\$529
HCE Totals	\$55,217	69.55%	
Non-Highly Compensated Employees (NHCE)	\$24,178	30.45%	
Total Plan Funding	\$79,396	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
Total Plan Funding (less rank-and-file deferrals)	\$79,396					
Tax Rates						
Federal		35.00%				
State (Median Rate)		TX 0.00%				
Medicare		2.90%				
Combined Tax Rate		37.90%				
Gross Tax Savings			\$30,091			
Less Medicare Tax of 2.9% on Owner Deferral				\$319		
Less Contribution for rank-and-file Employees					\$24,178	
Net Tax Savings						\$5,594

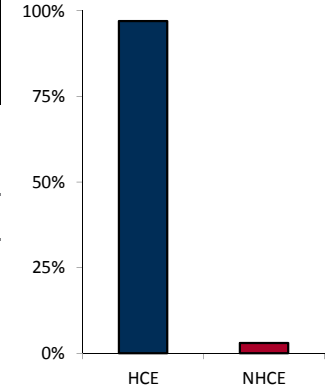
Proposed General Tested Cash Balance Plan with a 401(k) Cross-Tested PSP as of 12/31/2012

Implementation Advantages

1: Estimated Plan Funding Summary

Highly Compensated Employees (HCE)

	<i>Salary Deferral</i>	<i>Catch-Up</i>	<i>3% Safe Harbor</i>	<i>Profit Sharing</i>	<i>Cash Balance Plan Funding</i>	<i>Total Contribution</i>	<i>% of Total</i>	<i>Individual Tax Savings</i>
Owner	\$17,000	\$5,500	\$6,900	\$10,120	\$220,000	\$259,520	88.72%	\$92,216
Spouse*	\$17,000	\$5,500	\$720	\$1,056	\$0	\$24,276	8.30%	\$8,626
HCE Totals	\$34,000	\$11,000	\$7,620	\$11,176	\$220,000	\$283,796	97.02%	
Non-Highly Compensated Employees (NHCE)	\$0	\$0	\$2,685	\$4,029	\$2,000	\$8,714	2.98%	
Total Plan Funding						\$292,510	100.00%	



2: Estimated Tax Savings v. Funding Cost

	<i>Total Plan Funding</i>	<i>Tax Rates</i>	<i>Gross Tax Savings</i>	<i>Medicare Impact</i>	<i>Employer Contribution to Rank & File</i>	<i>Net Tax Savings</i>
Total Plan Funding (less rank-and-file deferrals)	\$292,510					
Tax Rates						
Federal			35.00%			
State (Median Rate)		TX	0.00%			
Medicare			2.90%			
Combined Tax Rate			37.90%			
Gross Tax Savings			\$110,861			
Less Medicare Tax of 2.9% on Owner Deferral				\$1,305		
Less Contribution for rank-and-file Employees					\$8,714	
Net Tax Savings						\$100,842

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