

# Qualified Retirement Plans for Small Business Owners

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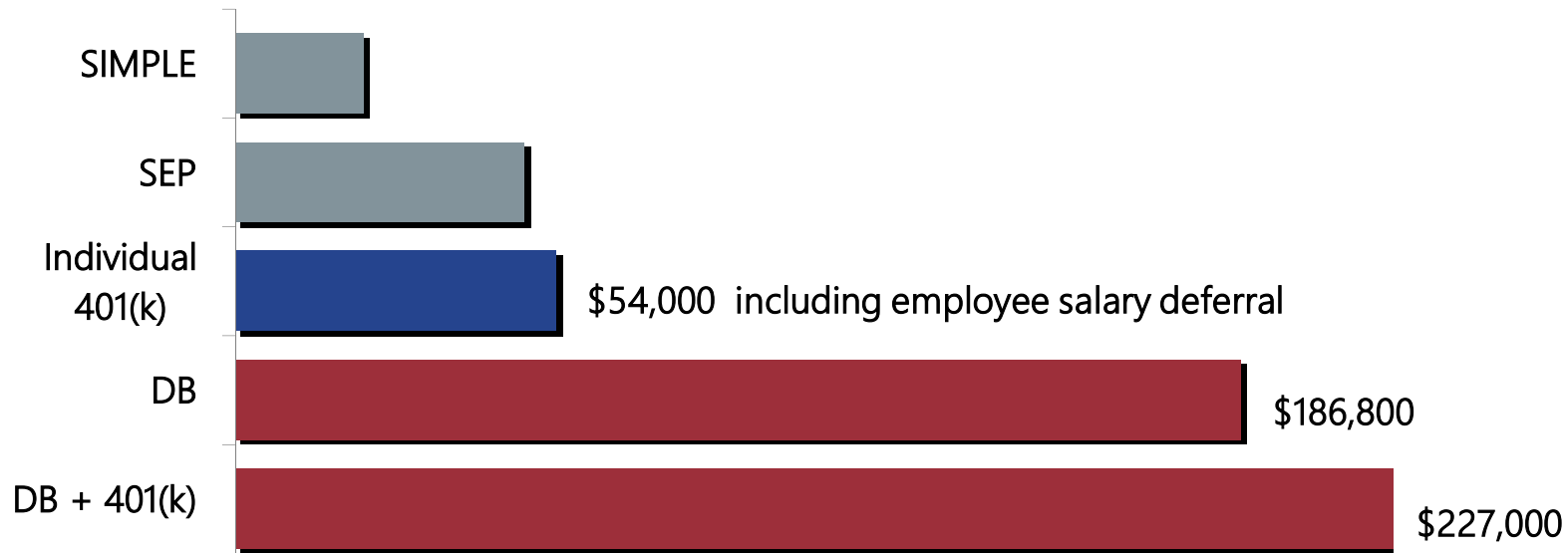
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# Qualified Plans vs. IRA Plans

- Covered under different IRS Code sections
- Subject to different set of laws and IRS rules
- IRA Plans – Traditional, Roth, Beneficiary, SEP/SAR-SEP, SIMPLE
  - Sources of information:
    - IRS Publication 590-a for IRA Contributions
    - IRS Publication 590-b for IRA Distributions
    - IRS Publication 560 for SEP and SIMPLE
- IRA plans are not covered in this presentation

# Comparison of Retirement Plans

Pension Plans Allow Business Owners to Contribute Significantly More Than Other Retirement Plans



Hypothetical Example: Maximum annual contribution limits in 2017 for a business owner age 52, earning \$270,000 W-2 income annually, retiring in 10 years

# Qualified Retirement Plans

- Governed by ERISA - federal law
  - Employee Retirement Income Security Act of 1974
- Profit Sharing including
  - Safe Harbor 401(k)
    - Employees other than family
  - SoloK / IndividualK / OnePerson 401(k)
    - No employees or employees are immediate family or p/t
    - Typically not subject to ERISA
- Pension Plans
  - Defined Benefit
  - Cash Balance

# Qualified Plans: DC vs. DB

## ✓ **Defined Contribution Plans**

- Profit Sharing Plans – 100% Employer Funded
- 401(k) Plans – include Employee Salary Deferral
  - Optional feature in Profit Sharing Plans
  - Allows employees to contribute and reduce taxable income
    - \$18,000 – under 50 years of age
    - \$24,000 – 50 years of age or older (includes \$6,000 “catch- up”)

## ✓ **Defined Benefit Plans – 100% Employer Funded**

- Traditional Defined Benefit Plans
- Cash Balance Plans - **hybrid between DC and DB**

# Employee Eligibility Criteria

- Eligibility Criteria – max (may be less stringent)
  - Age 21 or older
  - 1000 hours or more per year
  - 1 year of employment tenure
- Must include all employees who meet criteria
- May exclude:
  - Part-time employees – less than 1000 hrs
  - Union (collective bargaining) employees
  - Non-resident aliens

# Eligible Compensation

Compensation Quick Reference Chart		
Entity Type	Source of Income	Compensation for Plan
Corporation	W-2 Income	W-2 Income
S-Corporation	W-2 + Schedule K-1	W-2 Income only
Sole Proprietorship	Schedule C (net profit)	Earned Income (calculate)*
Partnership	Schedule K-1 (net profit)	Earned Income (calculate)*

Limited Liability Company (LLC) — compensation for plan depends on how LLC is taxed. See above.

Employees, other than owners, are paid W-2 income for all entity types.

\* Earned Income = net profit minus  $\frac{1}{2}$  of self-employment tax. Deductions for sole proprietors and partners in partnerships are limited to net profit minus  $\frac{1}{2}$  self-employment tax.

# Traditional 401(k)

- First generation of 401(k) plans
- Subject to “top heavy” testing:
  - Average Deferral Percentage (ADP)
  - Average Contribution Percentage (ACP)
  - Top Heavy test
    - 60% of plan assets belong to Highly Compensated Employees (HCEs) vs. Non-highly Compensated Employees (NHCs)
- Unattractive for small business owners
  - Ability to contribute depends on employees



# Safe Harbor 401(k)

- Non-discrimination and top-heavy testing are automatically satisfied based on contributions to Employees:
  - 3% non-elective contribution to all eligible
  - 4% match to all contributing
- Highly compensated employees (HCEs) can maximize contributions even if non-highly compensated (NHCs) employees contribute nothing or little

# 401(k) – Employee Contributions

- Participants can contribute up to the lesser of 100% of their “compensation” or \$18,000 in 2017 and \$18,500 in 2018
- Participants age 50 or older can make “catch-up contributions” up to \$6,000 for a total of \$24,500 in 2017

# 401(k) – Employer Contributions

- Employers can match salary deferrals based on a variety of formulas
- Employers can provide profit sharing contributions based on a variety of formulas
- Maximum employer contribution cannot exceed 25% of compensation; and includes:
  - Safe harbor contribution
  - Matching contribution
  - Profit Sharing contribution

# 401(k) Total Contribution Limit

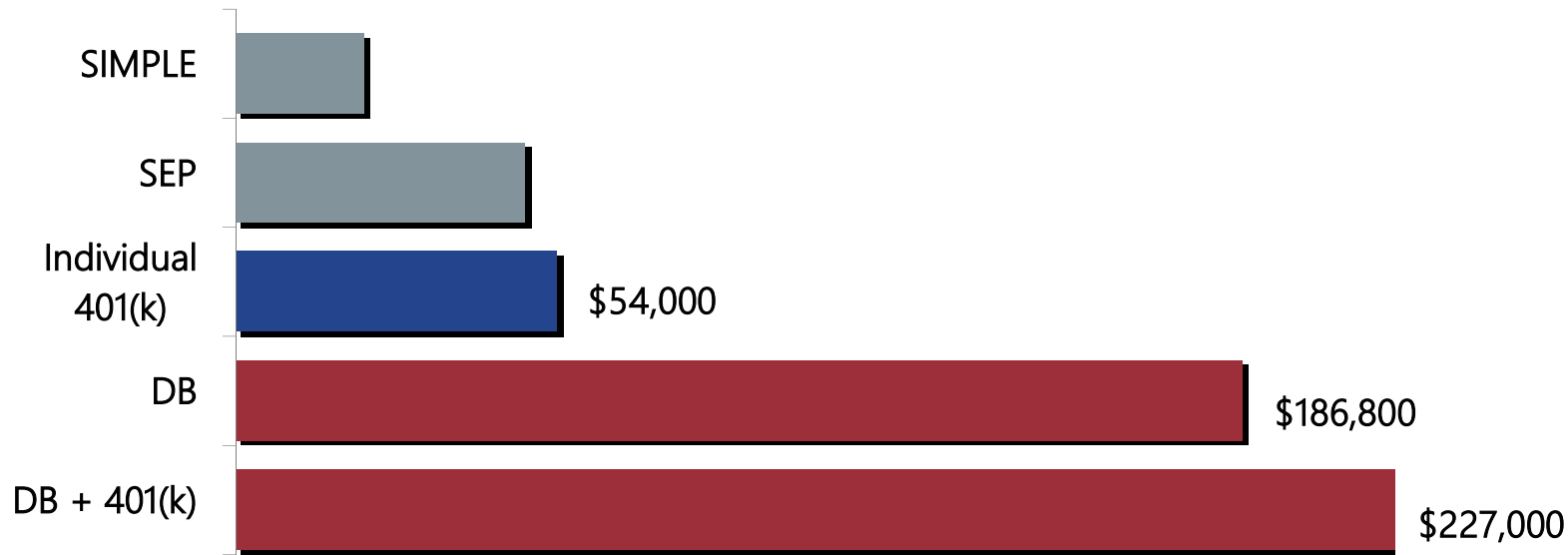
- The lesser of 100% of compensation or \$54,000 for 2017.
- The lesser of 100% of compensation or \$55,000 for 2018

# Pension Plans

- Defined Benefit and Cash Balance
- Provide specific benefit at retirement
- Suitable for:
  - Small, high revenue companies with
  - Business owners who want large deductions
  - No or few employees
  - Business owners who want to accumulate retirement assets in a short time

# Comparison of Retirement Plans

Pension Plans Allow Business Owners to Contribute Significantly More Than Other Retirement Plans



Hypothetical Example: Maximum annual contribution limits in 2017 for a business owner age 52, earning \$270,000 W-2 income annually, retiring in 10 years

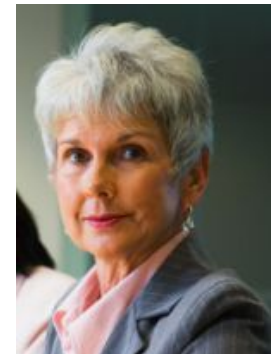
# Plan Design Considerations

- Number of owners
- Age of owners
- Owner's goals – typical:
  - Maximize deductions to owners
  - Minimize cost of funding employees benefits
- Number of eligible employees
- Number of family member employees
- Cash on hand and cash flow – present year and future years

# Self-Employed

**Susan, Age 60, is married to a high-income earning executive, and they do not need her income to maintain their lifestyle. They want to defer current taxes as much as possible.**

- Annual self-employment earnings: **\$100,000**
- DB contribution for 2017: **\$80,000**
- Annual tax savings: **\$30,400**
  - Combined marginal tax rate of 38%
- DB Accumulation at age 65: **\$463,800**
  - 5 years, 5-7% rate of return





# Owner-Only

**Kumar, Age 48, S-Corporation, No Employees**

- 2017 W-2 earnings: **\$185,000**
- Maximum DB contribution for 2017: **\$110,300**
- + 401(k) contribution for 2017: **\$29,100**
- Total deduction in 2017: **\$139,400**
- 2017 tax savings: **\$46,000**
  - Combined marginal tax rate of 33%
- DB Accumulation at age 62: **\$2.24 Million**
  - 14 years, 5-7% rate of return
- Annual DB Benefit: **\$185,000**



# Married Business Owners with No Employees

## Paul, Age 60 and Mary, Age 58

- 5 years from retirement
- W-2 Income: **\$540,000** (\$270,000 each)
- Total annual DB contribution: **\$429,500**
  - **\$209,700** towards Paul's retirement
  - **\$219,800** towards Mary's retirement
- Annual combined income tax savings: **\$163,200\***
- Accumulation at retirement:
  - Paul: **\$1.21 Million**
  - Mary: **\$1.27 Million**



\* Assumes a 38% combined marginal tax rate

# Physician – No Partners

**Dr. Charles, Age 52**  
**Wants Maximum Tax Deduction**

- Annual earnings: **\$500,000**
- Maximum DB + 401(k) contribution for 2017: **\$227,000**
  - Contribution to DB Plan: **\$186,800**
  - Contribution to 401(k): **\$40,200**
- Annual tax savings: **\$86,200**
  - Combined marginal tax rate of 38%
- DB Accumulation at age 62: **\$2.60 Million**
  - 10 years, 5-7% rate of return
- Annual DB Benefit: **\$215,000**



## **A Combination Cash Balance/401(k) Plan Analysis for**

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**Mary Moon**

### **Prepared by:**

Daphne M. Weitzel, CPC, QPA  
Alliance Benefit Group of Illinois  
November 06, 2017

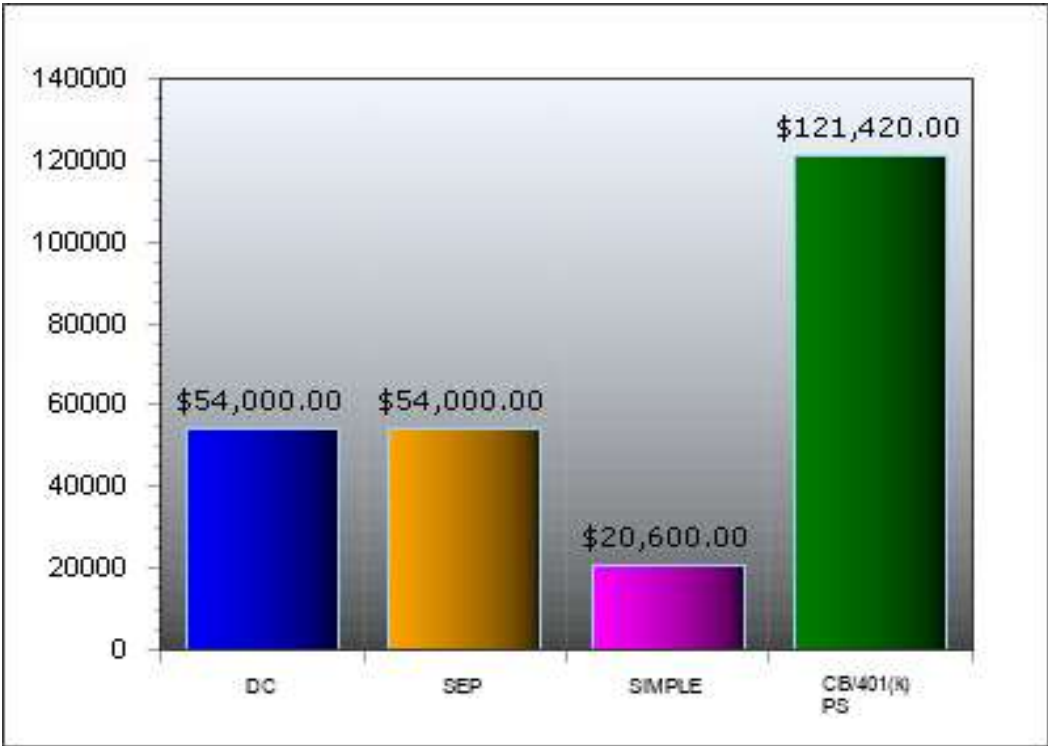
**Mary Moon (Regular Corporation)**

**Participant: Mary Moon Age: 40 Ret. Age: 62**

**W2-Income: \$270,000**

**Considered Earnings \$270,000**

<u>Plan Type</u>	<u>Contribution Type</u>	<u>Contribution Amount</u>	<u>Total</u>
Defined Contribution Plan			\$ 54,000
	Profit Sharing Allocation	\$ 36,000	
	401(k) Deferral	\$ 18,000	
SEP			\$ 54,000
SIMPLE Plan			\$ 20,600
	401(k) Deferral	\$ 12,500	
	SIMPLE Matching Contribution	\$ 8,100	
Combination Cash Balance/401(k) Profit Sharing			\$ 121,420
	Profit Sharing Contribution	\$ 16,200	
	Cash Balance Pay Credit	\$ 87,220	
	401(k) Deferral	\$ 18,000	



**Mary Moon**

Benefit Projection for Mary Moon  
For the Plan Year 01/01/2017 to 12/31/2017

**Personal Data**

<b>Date of Birth:</b>	09/06/1977	<b>Retirement Age:</b>	62	<b>Considered Past Service:</b>	0
<b>W2-Income:</b>	\$270,000	<b>Current Age:</b>	40	<b>Annual Pay Credit:</b>	\$87,220
<b>Considered Earnings:</b>	\$270,000			<b>Funding Years:</b>	23

**Plan Provisions**

**Cash Balance/401(k) Profit Sharing**

Benefit Formula: Pay Credit of \$87,220 per year with Interest credited at 5.0% per year.  
Actuarial Equivalence Assumptions: Pre-Retirement Interest - 5.00% Interest Only; Post-Retirement - 5.00% Interest w/ 94GAR (50/50) Mortality

**Defined Contributions**

401(k) Deferral: Maximum allowed plus catchup when eligible  
Profit Sharing: 6% of Considered Earnings.

		Cash Balance Plan			Defined Contribution Plan				Combined			
Yr	Age	Pay Credit	Pay Credit @ 5.00%	415 Lump Sum Limit	Annual Deferral	P.S. Contrib	Total DC	Total DC@5%	CB+DC Annual	35% Saving	Net Contrib	Total Lump Sum
1	40	87,220	87,220	87,220	18,000	16,200	34,200	34,200	121,420	42,497	78,923	121,420
2	41	87,220	178,801	183,311	18,000	16,200	34,200	70,110	121,420	42,497	78,923	248,911
3	42	87,220	274,961	288,952	18,000	16,200	34,200	107,816	121,420	42,497	78,923	382,777
4	43	87,220	375,929	404,864	18,000	16,200	34,200	147,407	121,420	42,497	78,923	523,335
5	44	87,220	481,945	531,847	18,000	16,200	34,200	188,977	121,420	42,497	78,923	670,922
6	45	87,220	593,262	670,726	18,000	16,200	34,200	232,626	121,420	42,497	78,923	825,888
7	46	87,220	710,145	822,373	18,000	16,200	34,200	278,457	121,420	42,497	78,923	988,603
8	47	87,220	832,872	987,731	18,000	16,200	34,200	326,580	121,420	42,497	78,923	1,159,453
9	48	87,220	961,736	1,167,847	18,000	16,200	34,200	377,109	121,420	42,497	78,923	1,338,845
10	49	87,220	1,097,043	1,363,750	18,000	16,200	34,200	430,164	121,420	42,497	78,923	1,527,208
		872,200	-	-	180,000	162,000	342,000	-	1,214,200	424,970	789,230	-
11	50	87,220	1,239,115	1,433,299	24,000	16,200	40,200	491,872	127,420	44,597	82,823	1,730,988
12	51	87,220	1,388,291	1,506,482	24,000	16,200	40,200	556,666	127,420	44,597	82,823	1,944,958
13	52	87,220	1,544,926	1,583,349	24,000	16,200	40,200	624,699	127,420	44,597	82,823	2,169,625
14	53	42,035	1,664,207	1,664,207	24,000	16,200	40,200	696,134	82,235	28,782	53,453	2,360,342
15	54	1,794	1,749,211	1,749,211	24,000	16,200	40,200	771,141	41,994	14,698	27,296	2,520,353
16	55	1,836	1,838,508	1,838,508	24,000	16,200	40,200	849,898	42,036	14,713	27,323	2,688,406
17	56	2,018	1,932,451	1,932,451	24,000	16,200	40,200	932,593	42,218	14,776	27,442	2,865,045
18	57	2,116	2,031,190	2,031,190	24,000	16,200	40,200	1,019,423	42,316	14,811	27,505	3,050,613
19	58	2,219	2,134,968	2,134,968	24,000	16,200	40,200	1,110,594	42,419	14,847	27,572	3,245,563
20	59	2,409	2,244,125	2,244,125	24,000	16,200	40,200	1,206,324	42,609	14,913	27,696	3,450,450
21	60	2,577	2,358,908	2,358,908	24,000	16,200	40,200	1,306,840	42,777	14,972	27,805	3,665,749
22	61	2,659	2,479,512	2,479,512	24,000	16,200	40,200	1,412,382	42,859	15,001	27,858	3,891,896
23	62	2,850	2,606,338	2,606,338	24,000	16,200	40,200	1,523,201	43,050	15,068	27,983	4,129,540
<b>Grand Totals</b>		<b>1,196,373</b>			<b>492,000</b>	<b>372,600</b>	<b>864,600</b>		<b>2,060,973</b>	<b>721,341</b>	<b>1,339,632</b>	

**JONES AND PRIEST PHYSICIANS PLLC**  
**A Combination 401(k) / Profit Sharing / Cash Balance Plan**  
**For the Plan Year 01/01/2017 - 12/31/2017**  
**CONTRIBUTION REPORT - DETAIL**

P	O	H	Class	Last Name	First Name	AA	RA	Considered Earnings	Cash Balance		401(k) Deferral	Profit Sharing		Total Contribution				
									Amount	%		Amount	%	Employer		% of		
														Amount	%	Cost	%	Total
*	*	*	A	Jones	Austin	36	62	270,000	70,200	26.0	18,000	16,200	6.0	104,400	38.7	86,400	32.0	50.0
*	*	*	A	Priest	Joe	42	62	270,000	70,200	26.0	18,000	16,200	6.0	104,400	38.7	86,400	32.0	50.0

Legend: P- Principal, O- Owner, H- Highly Compensated Employee

**CONTRIBUTION REPORT - SUMMARY**

	Considered Earnings	Cash Balance		401(k) Deferral	Profit Sharing		Total Contribution				
		Amount	%		Amount	%	Employer		% of		
							Amount	%	Cost	%	Total
Principals	540,000	140,400	26.0	36,000	32,400	6.0	208,800	38.7	172,800	32.0	100.0
Grand Total	540,000	140,400	26.0	36,000	32,400	6.0	208,800	38.7	172,800	32.0	100.0

**ABC, LLC**  
**A Combination 401(k) / Profit Sharing / Cash Balance Plan**  
**For the Plan Year 01/01/2018 - 12/31/2018**  
**CONTRIBUTION REPORT - DETAIL**

P	O	H	Class	Last Name	First Name	AA	RA	Considered Earnings	Cash Balance		401(k) Deferral	Safe Harbor	Profit Sharing		Total Contribution				
									Amount	%			Amount	%	Employer		% of		
															Amount	%	Cost	%	Total
*	*	*	A	JONES	TOM	60	64	140,000	168,000	120.0	24,500	0	3,500	2.5	196,000	140.0	171,500	122.5	78.4
*	*		B	JONES	MELINDA	53	62	50,000	35,000	70.0	24,500	0	1,250	2.5	60,750	121.5	36,250	72.5	16.6
		*	C	JONES	TOM, Jr.	36	62	62,000	0	0.0	0	0	6,200	10.0	6,200	10.0	6,200	10.0	2.8
			N	BROWN	DARWIN	32	62	48,000	0	0.0	0	1,440	3,360	7.0	4,800	10.0	4,800	10.0	2.2

Legend: P- Principal, O- Owner, H- Highly Compensated Employee

**CONTRIBUTION REPORT - SUMMARY**

	Considered Earnings	Cash Balance		401(k) Deferral	Safe Harbor	Profit Sharing		Total Contribution				
		Amount	%			Amount	%	Employer		% of		
								Amount	%	Cost	%	Total
<b>Principals</b>	<b>190,000</b>	<b>203,000</b>	<b>106.8</b>	<b>49,000</b>	<b>0</b>	<b>4,750</b>	<b>2.5</b>	<b>256,750</b>	<b>135.1</b>	<b>207,750</b>	<b>109.3</b>	<b>95.0</b>
<b>Non-Principals</b>	<b>110,000</b>	<b>0</b>	<b>0.0</b>	<b>0</b>	<b>1,440</b>	<b>9,560</b>	<b>8.7</b>	<b>11,000</b>	<b>10.0</b>	<b>11,000</b>	<b>10.0</b>	<b>5.0</b>
<b>Grand Total</b>	<b>300,000</b>	<b>203,000</b>	<b>67.7</b>	<b>49,000</b>	<b>1,440</b>	<b>14,310</b>	<b>4.8</b>	<b>267,750</b>	<b>89.3</b>	<b>218,750</b>	<b>72.9</b>	<b>100.0</b>



**ABC, LLC**  
**A Combination 401(k) / Profit Sharing / Cash Balance Plan**  
**For the Plan Year 01/01/2018 - 12/31/2018**  
**CASH BALANCE TAX SUMMARY REPORT**

<b>Assumed Tax Brackets</b>	<b>40%</b>	<b>45%</b>
Employer Contribution	218,750	218,750
Estimated Tax Savings	87,500	98,438
Net Cost After Estimated Tax Savings	131,250	120,313
Contribution For Principals	207,750	207,750
Principal Contribution As A Percentage Of Net Cost	158.29%	172.68%
Net Cost Of Plan (After Principal Contribution And Tax Savings)	-76,500	-87,438

# Impact of Age in DB Plans: The Older, The Better

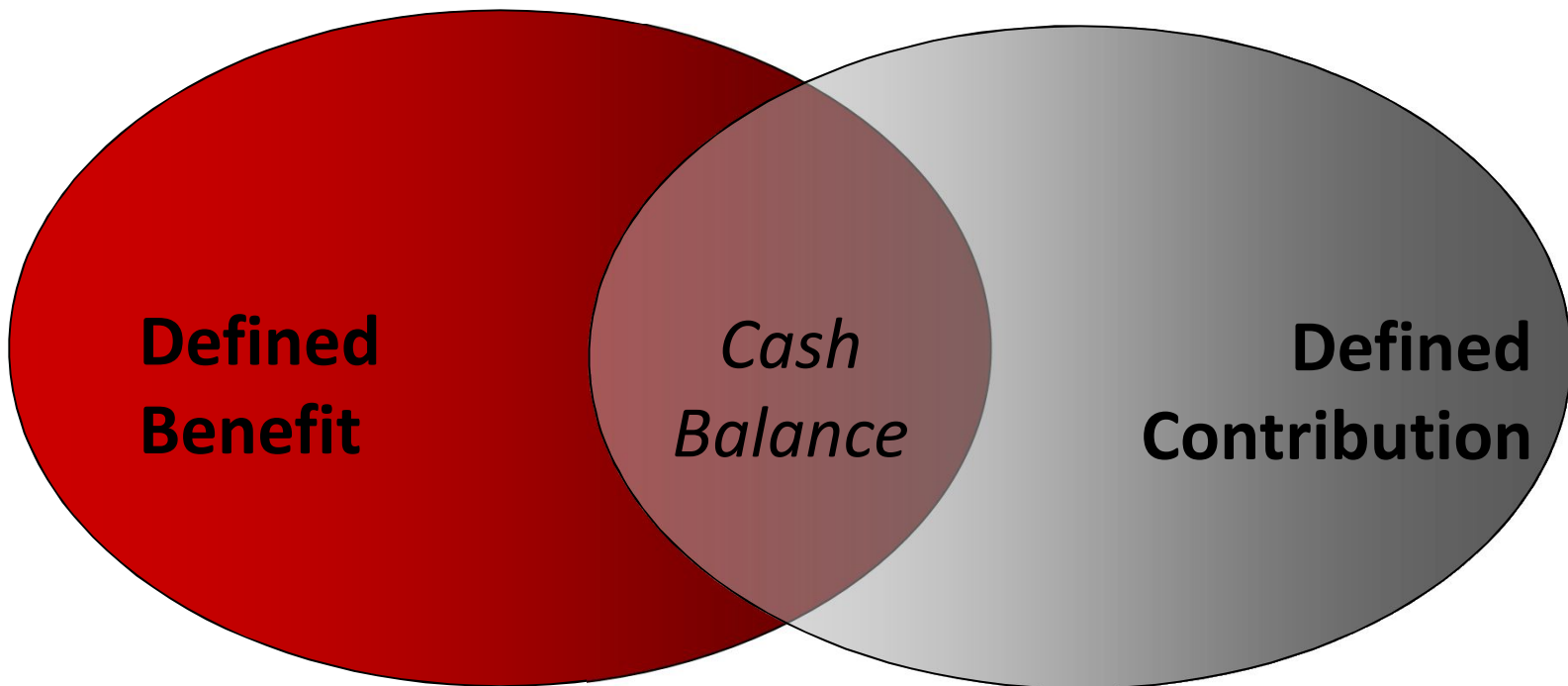
## Doctor Charles

- **Age 52**
- 10 Years to Retirement
- Compensation: \$500,000
- DB Contribution: **\$186,800**
- Annual Benefit at Retirement:  
\$215,000

## Doctor Preston

- **Age 35**
- 27 Years to Retirement
- Compensation: \$500,000
- DB Contribution: **\$71,300**
- Annual Benefit at Retirement:  
\$215,000

# Cash Balance – Hybrid Plan



**An ERISA-governed, tax-qualified plan**

- Tax deduction, tax deferral
- Creditor protection

# How Do Cash Balance Plans Work?

## 401(k)

Contribution



Earnings



## Cash Balance

Contribution



**Guaranteed  
Annual Credit  
( $\approx 4\%$ )**



# Define Benefit vs. Cash Balance

## Defined Benefit Plans

- Age-sensitive
- Present value accrued benefit

## Cash Balance Plans

- Age-neutral (relatively)
- Account balance

## Contribution Flexibility Among Partners

Owners/partners can have **different** amounts contributed for them

<u>Example:</u>	<u>Cash Balance Contribution</u>
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Partner 1, age 50:	<b>\$100,000</b>
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Partner 2, age 48:	<b>\$0</b>
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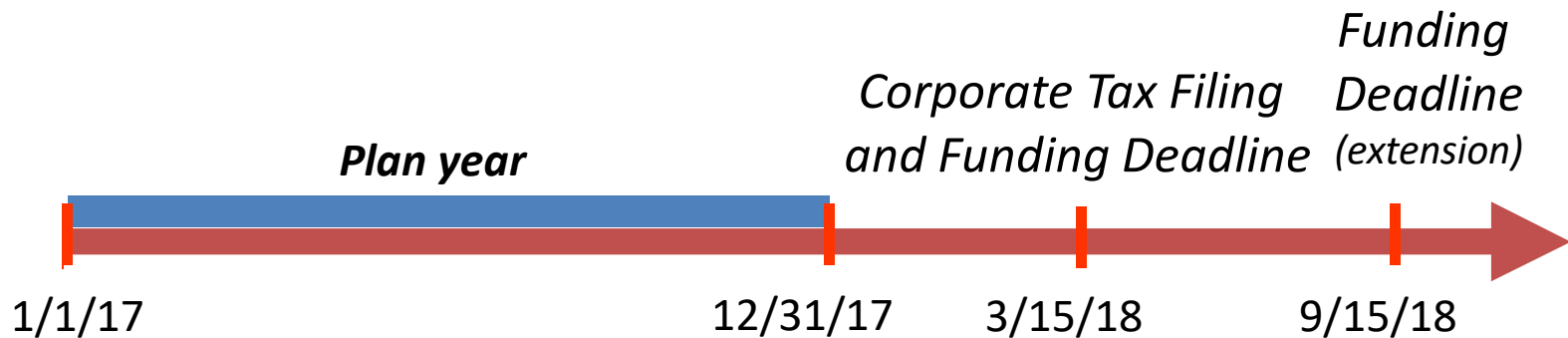
# Cash Balance – Hybrid Plan



<b>Owners</b>	<b>401(k)</b>	<b>Profit Sharing</b>	<b>Cash Balance</b>	<b>TOTAL CONTRIBUTION</b>
Owner 1	\$ 23,000	\$ 28,000	\$ 229,000	\$ 280,000
Owner 2	17,500	28,000	25,000	76,000
<b>Employees</b>		<i>7.5% of pay</i>		
Jones		6,675	\$ 650	7,325
Keeler		6,600	650	7,250
Marion		3,975	650	4,625
Baldwin		3,750	650	4,400
Dupre		3,600	650	4,250
Ophir		2,925	650	3,575
Smith		3,000	650	3,650
Sabotin		2,625	650	3,275
Parotta		1,125	650	1,775
Keebler		1,050	650	1,700
<b>Subtotal</b>		<b>\$ 35,325</b>	<b>\$ 6,500</b>	<b>\$ 41,825</b>
<b>Total</b>				<b>\$ 397,825</b>
<i>Percent to Owners</i>				<b>89%</b>

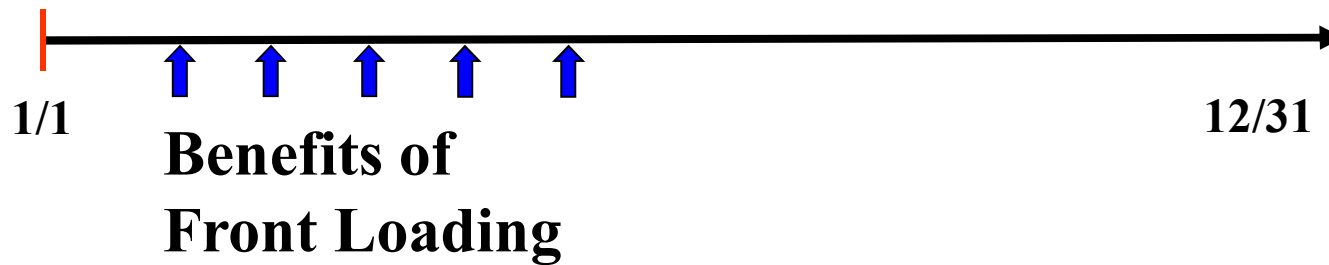
# Pension Plan Funding

## Funding of Pension Plan in 2017 for corporations





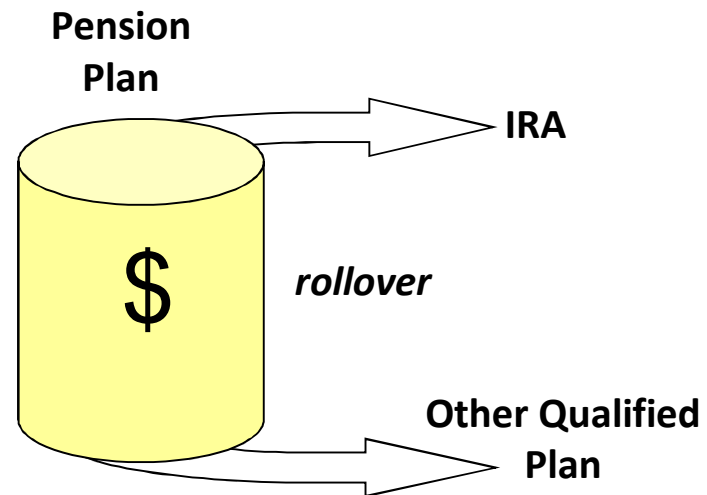
# Cash Balance Plan Funding



- Puts money to work earlier in the year
- Helps generate more income
- Suitable for co.'s with stable cash flow and/or large cash positions

# Portability Options

Assets are portable



# Suitable Prospects

- High income persons
- Typically professionals – doctors, dentists, etc.
- Stable business or practice
- Want large tax deductions
- Able to fund Plan for at least 3 years
- Stable cash flow
- No or few employees is best but not a must
- Family members are (or can be) on payroll

# Evaluation Process

- Need Employee Census in Excel
- Third Party Administrator (TPA) provides:
  - Illustration
  - Proposal
- Plan established
- Plan funded – initial contribution
- Plan funded – periodic contributions



# Questions