# ftwilliam.com: Defined Benefit Webinar

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# Speakers and Agenda

- Charles Brown, EA, FCA, MSEA, QPA, QKA – Associate Consulting Director
  - Defined benefit plan tax advantages and implications under the SECURE Act

- Joe Kleinrichert, PMP, CSM – Senior Technology Project & Program Manager
  - Specific examples using ftwilliam.com's new Defined Benefit/Combo Proposal module

# Plan designs

- Defined contribution plans
  - Employee contributions – 401(k) deferrals (pretax or roth), after-tax
  - Employer contributions – match or profit sharing
  - Contributions are discretionary, unless safe harbor
  - Annual additions limited by IRC 415(c)
    - 100% of compensation or $58,000 (2021)
  - Deductions limited by IRC 404(a)(3)
    - 25% of compensation

# Plan designs

- Defined benefit / cash balance plans
  - Employer contributions only
  - Benefits limited by IRC 415(b)
    - Based on average compensation, not current compensation
  - Minimum required and maximum deductible contributions amounts determined annually by actuary
  - Cash balance plans are defined benefit plans with a more understandable benefit formula (Principal credits, Interest credits, etc.)
- DB/DC combo
  - Two plans (DB and DC) maintained simultaneously for increased contribution limits and/or testing advantages

# Plan designs

Defined benefit/cash balance contribution limits (approximate)-

| Age | Maximum Benefit | Maximum Contribution |
|---|---|---|
| 35 | 77,000 | 164,000 |
| 45 | 126,000 | 262,000 |
| 55 | 207,000 | 356,000 |
| 65 | 277,000 | 415,000 |

These assume compensation over $230,000. Lower compensation may reduce limits.

# Plan designs

Maximum contributions to a DB/DC combo in 2020-

| Age | 401(k) Deferral (Pretax or Roth) | DC Employer Contributions | Maximum DB/CB Benefit | Total |
|---|---|---|---|---|
| 35 | 19,500 | 17,100 | 77,000 | 96,050 |
| 45 | 19,500 | 17,100 | 126,000 | 162,600 |
| 55 | 26,000 | 17,100 | 207,000 | 250,100 |
| 65 | 26,000 | 17,100 | 277,000 | 320,100 |

Assumes compensation over $285,000. Lower compensation may reduce limits.
Assumes DB plan not covered by PBGC.

# Plan designs

Required testing-

| Compliance test | Required for DC Plan | Required for DB(CB) Plan | DB/DC can address as a single plan |
|---|---|---|---|
| Coverage | Yes | Yes | Yes |
| Nondiscrimination | Yes | Yes | Yes |
| Top Heavy minimums | Yes | Yes | Yes |
| ADP/ACP | Yes | No | N/A |
| Minimum participation | No | Yes | N/A |

# SECURE Act sales opportunities

- Retroactive adoption of plans
  - Effective for tax years beginning after December 31, 2019 a plan may be adopted as late as the extended tax filing deadline (i.e., September 15, 2021 for a 2020 calendar tax filer)
    - Previous deadline was last day of tax year
    - Excludes 401(k) features
      - Example: profit sharing effective 1/1/2020, 401(k) features effective 7/1/2021

# SECURE Act sales opportunities

- Safe harbor redesigns
  - Effective for plan years beginning after December 31, 2019 a plan may be amended at least 30 days before the last day of the year to be a 3% nonelective safe harbor, or

    Up to the last day of the *following* plan year to be a 4% nonelective safe harbor
    - Be aware of deduction issues…
  - Previously a plan had to be safe harbor at the beginning of a plan year, or not at all

# Retroactive adoption

- Before 2020 a SEP IRA was the only option after year-end
- SEP IRAs have many disadvantages
  - Pro-rata or integrated contribution allocations
  - No vesting schedule
  - No distribution restrictions
- New law should result in adoption of profit sharing and DB/DC combinations over SEPs

# SEP IRA

| | Age | HCE | Comp | SEP IRA Contribution | % |
|---|---|---|---|---|---|
| Owner | 58 | Yes | 200,000 | 50,000 | 25.00% |
| Employee | 40 | No | 60,000 | 15,000 | 25.00% |
| Employee | 25 | No | 30,000 | 7,500 | 25.00% |
| Employee | 55 | No | 45,000 | 11,250 | 25.00% |
| Employee | 32 | No | 40,000 | 10,000 | 25.00% |
| Totals | | | 375,000 | 93,750 | |

**Results:**

| | |
|---|---|
| Total tax deduction | 93,750 |
| Amount to Owner | 50,000 |
| Amount to Non-Owners | 43,750 |
| Percent to Owner | 53.33% |

# Cross-Tested Profit Sharing Plan

| | Age | HCE | Comp | Profit Sharing Contribution | % |
|---|---|---|---|---|---|
| Owner | 58 | Yes | 200,000 | 57,000 | 28.50% |
| Employee | 40 | No | 60,000 | 3,000 | 5.00% |
| Employee | 25 | No | 30,000 | 1,500 | 5.00% |
| Employee | 55 | No | 45,000 | 2,250 | 5.00% |
| Employee | 32 | No | 40,000 | 2,000 | 5.00% |
| Totals | | | 375,000 | 65,750 | |

**Results:**

| | |
|---|---|
| Total tax deduction | 65,750 |
| Amount to Owner | 57,000 |
| Amount to Non-Owners | 8,750 |
| Percent to Owner | 86.69% |

# Profit Sharing and Cash Balance Plan

| | Age | HCE | Comp | Profit Sharing Contribution | % | Cash Balance Contribution | % | Total |
|---|---|---|---|---|---|---|---|---|
| Owner | 58 | Yes | 200,000 | 9,375 | 4.69% | 130,000 | 65.00% | 139,375 |
| Employee | 40 | No | 60,000 | 4,500 | 7.50% | 500 | 0.83% | 5,000 |
| Employee | 25 | No | 30,000 | 2,250 | 7.50% | 500 | 1.67% | 2,750 |
| Employee | 55 | No | 45,000 | 3,375 | 7.50% | 500 | 1.11% | 3,875 |
| Employee | 32 | No | 40,000 | 3,000 | 7.50% | 500 | 1.25% | 3,500 |
| Totals | | | 375,000 | 22,500 | | 132,000 | | 154,500 |

**Results:**

| | |
|---|---|
| Total tax deduction | 154,500 |
| Amount to Owner | 139,375 |
| Amount to Non-Owners | 15,125 |
| Percent to Owner | 90.21% |

# Retroactive Plan Options for 2020

| | SEP IRA | Cross-Tested Profit Sharing | PS/CB Combination |
|---|---|---|---|
| Total tax deduction | 93,750 | 65,750 | 154,500 |
| Amount to Owner | 50,000 | 57,000 | 139,375 |
| Amount to Non-Owners | 43,750 | 8,750 | 15,125 |
| Percent to Owner | 53.33% | 86.69% | 90.21% |

# Let’s test drive the proposal system

# Benefits of retroactive adoption

- Potentially 1 1/2 years-worth of actual data available before plan adoption
  - Census
    - Who is getting a benefit and how much…
  - Contribution cost
  - Business profitability

# Scenario 1 – No existing plan

Facts-

- The business needs tax deductions for 2020.
- Extension has been filed to 9/15/2021.
- There is no existing plan.

Options-

- Adopt one or more plans retroactive to the 2020 tax year
- Use a profit sharing plan, defined benefit/cash balance or combination DB/DC as needed.

# Scenario 2 – Existing DC plan

Facts-

There is a defined contribution plan in place for 2020.

Options (one or more may apply)-

- Add safe harbor 4% nonelective to existing plan to fix ADP or Top Heavy
  - Also counts toward gateway requirement for nondiscrimination test
- Retroactively adopt a 2nd DC plan (i.e., to add cross-tested PS formula)
  - Can consolidate into the existing plan in the following year

# Scenario 2 – Existing DC plan

Options (cont…)-

- Retroactively adopt a defined benefit/cash balance plan
  - Provide much larger contributions and deductions
  - Amendment under Treas. Reg. 1.401(a)(4)-11(g) can be used to fix prior year testing issues

# Safe Harbor redesign

Facts-

It is July of 2021. The company has a non-safe harbor 401(k) plan and ADP testing is failing for 2020. Plus, they didn't process refunds by 3/15/2021, so there is a 10% excise tax due.

Options-

Amend the plan to be a safe harbor 4% nonelective for 2020. This negates the ADP refunds and excise tax. Plus, the 4% nonelective contribution counts toward the gateway for nondiscrimination testing. *This is especially useful if a cash balance plan is being retroactively added for 2020*.

# Did you know… (RMDs)

That defined benefit plans are more flexible for owner RMDs. Unlike a defined contribution plan, participants in defined benefit plans don’t have to take RMDs until they have a vested benefit.

Example:

A 75 year-old owner starts a cash balance plan with 3-year cliff vesting that excludes service prior to the effective date. They won’t have to start RMDs until the year after they become 100% vested, which will be the 4$^{th}$ plan year (age 78).

# Did you know…(S-corp compensation)

Since the maximum deductible contribution calculation in a defined benefit plans is not based on current year compensation and the IRS considers retirement plan contributions to be part of “reasonable compensation”, you can substantially shift an S-corporation shareholder’s W-2 amount into defined benefit plan contributions.

Example on next slide

# Did you know (cont)…

Consider an S-corporation with $150,000 available for owner compensation and benefits that establishes a defined benefit plan for 2020-

| | 2019 | 2020 |
|---|---|---|
| Owner’s W-2 comp | 120,000 | 10,000 |
| Owner’s retirement plan contribution | 0 | 139,235 |
| Owner’s shareholder distribution | 20,820 | 0 |
| Payroll taxes | 18,360 | 1,530 |
| Taxable income | 130,820 | 9,235 |

# Benefits of ftwilliam DB proposal

- Benefits of ftwilliam DB proposal-
  - Show up to five scenarios side-by-side
  - Easy benefit formulas
    - "Maximize for IRC 415"
    - "Minimum for IRC 401(a)(26)"
    - Flat dollar or % of pay
  - Actual valuation system
    - The IRC 430 and 404 min/max calculations in proposal use the same engine as the valuation system
      - No "surprises" in the first year

# Benefits of ftwilliam DB proposal

- Benefits of ftwilliam DB proposal (cont…)-
  - Import census from DC compliance system, a spreadsheet template or key in using the interface
  - Use an opening hypothetical account balance for lower minimums and higher maximums
  - Detailed testing reports available
  - Customizable proposal report with your logo

# Key Points

- The SECURE Act added options that allow the retroactive adoption or redesign of plan arrangements late into the following year.
- Consultants should be aware of how to employ these strategies for the benefit of new or existing clients.
- Defined benefit / cash balance plans are often necessary to fully take advantage of these opportunities.

# Questions