ftwilliam.com: Defined Benefit Webinar

8/19/2020

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Speakers and Agenda

- Joe Kleinrichert – Senior Technology Project & Program Manager
  - Demo of ftwilliam.com's new Defined Benefit Proposal module and preview of the full Defined Benefit Valuation software that will be available later this year

- Charles Brown – Consulting Actuary
  - How to leverage defined benefit plans to fully take advantage of the new SECURE Act sales strategies, such as post year-end plan adoptions and safe harbor redesigns.

Agenda

- Safe harbor redesign strategies
- Retroactive adoption strategies
- Why defined benefit / cash balance plans?

Safe Harbor Redesign Strategies

- Old law – a plan must have a safe harbor design on the first day of the plan year in order to get safe harbor treatment (ADP and top heavy exemption)
- SECURE Act (eff. for 2020 plan years) –
  - 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

Safe Harbor Redesign Strategies

Example 1

Problem-

A non-safe harbor 401(k) plan is top heavy for 2020 and key employees have made deferrals, thereby triggering a 3% minimum allocation to non-owner employees.

Solution-

Amend the plan before 12/1/2020 to be a safe harbor 3% nonelective. Key employees can now make maximum deferrals for 2020 without refunds. Plus, non-owner Highly Compensated Employees can be excluded from the safe harbor contribution. (Note that any non-Safe Harbor contribution allocation will again trigger top heavy minimums)

Safe Harbor Redesign Strategies

Example 2

Problem-

It is January of 2021. The owner's CPA tells them that 2020 was a very good year and they need deductions. They have a non-safe harbor 401(k) plan and are getting ADP refunds.

Solution-

Amend the plan to be a safe harbor 4% nonelective for 2020. This stops ADP refunds. The 4% nonelective contribution counts toward the gateway for nondiscrimination testing, so the owner can potentially get an additional 8% profit sharing (total 12% with safe harbor) without allocating anything additional to the NHCEs.

Retroactive Adoption Strategies

- Old law – a plan must be adopted no later than the last day of a plan sponsor's tax year to get a deduction for contributions
- SECURE Act (eff. for 2020 tax year) – certain types of plans may be adopted retroactive to the prior tax year as late as the tax filing due date (including extensions)
  - Profit sharing
  - Defined benefit / cash balance
- Plans can be retroactively adopted for 2020 as late as 9/15/2021?
  - Most likely a big surge from January – March 2021

Retroactive Adoption Strategies

- 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%

Why Defined Benefit / Cash Balance Plans?

- Higher contribution limits
- Deductions based on benefits, not 25% of compensation
- RMDs based on vested benefit, not total account balance
  - Owner over age 72 can generally delay RMDs for three years from start of plan
- Ability to combine with 401(k) and profit sharing plans for testing

Key Points

- The SECURE Act added options that allow the retroactive adoption or redesign or 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 plans (cash balance and traditional) are often necessary to fully take advantage of these opportunities.