BEST MONTHLY WEBINAR

Small Business Retirement Plans

Presented by:

Edward J. Barrett
CFP®, ChFC®, CLU, CEBS®, RPA, CRPS®, CRPC®, CPFA
Founder, President & CEO

1-800-345-5669 www.brokered.net
customerservice@brokered.net

Continuing Education

- Approved for 1-Hour of CE credit: CFP ®, CIMA® /CPWA®.
  - BEST will report the completed credit on your behalf (50 minutes)
- Monthly Live Webinar Series
  - April 17, 2018: Retirement Income Planning
- BEST 800-345-5669
- Email: ebarrett@brokered.net

Disclaimer

- The information and/or the materials provided as part of this program are intended and provided solely for informational and educational purposes. None of the information and/or materials provided as part of this power point or ancillary materials are intended to be, nor should they be construed to be, the basis of any investment, legal, tax or other professional advice. Under no circumstances should the audio, power point or other materials be considered to be, or used as, independent legal, tax, investment or other professional advice. The discussions are general in nature and not person specific. Laws vary by state and are subject to constant change. Economic developments could dramatically alter the illustrations or recommendations offered in the program or materials.

Our Agenda

- Overview of Small Businesses in the U.S.
- Qualified Retirement Plans for Small Businesses
- Employer Sponsored IRA Plans
- Qualified Retirement Plans
- Keogh Plans

The Small Business Market in the U.S.

- **What is a small business?**
  - The SBA Office of the Advocacy defines a small business as an independent business having fewer than 500 employees.
  - The IRS defines small businesses as those entities with less than $10 million of assets.

"Main Street America" Small Business Saturday

Source: [1] U.S. Census Bureau Statistics, http://uscensus/gov/econ/smallbus.html; [2] U.S. Census Bureau; https://www.census.gov/data/tables/2015/econ/susb/2015-susb-annual.html; National Small Business 2017 Yearn-End Economic Report http://nsba.biz/research/

The Small Business Market in the U.S.

- **Small Businesses in America: Not So Small After All**
  - In 2015 (latest data available) there were 30.2 million small businesses in the U.S. employing over 60 million people and responsible for creating 1.4 million net new jobs[1]
  - Small employers comprise 99.7% of all employer firms in the U.S.
    - 1 in 2 workers in the private workforce run or work for a small business;
    - 1 in 4 individuals in the total U.S. population is part of the small business community.

Source: [1] U.S. Census Bureau Statistics, http://uscensus/gov/econ/smallbus.html; [2] U.S. Census Bureau; https://www.census.gov/data/tables/2015/econ/susb/2015-susb-annual.html; National Small Business 2017 Yearn-End Economic Report http://nsba.biz/research/

The Small Business Market in the U.S.

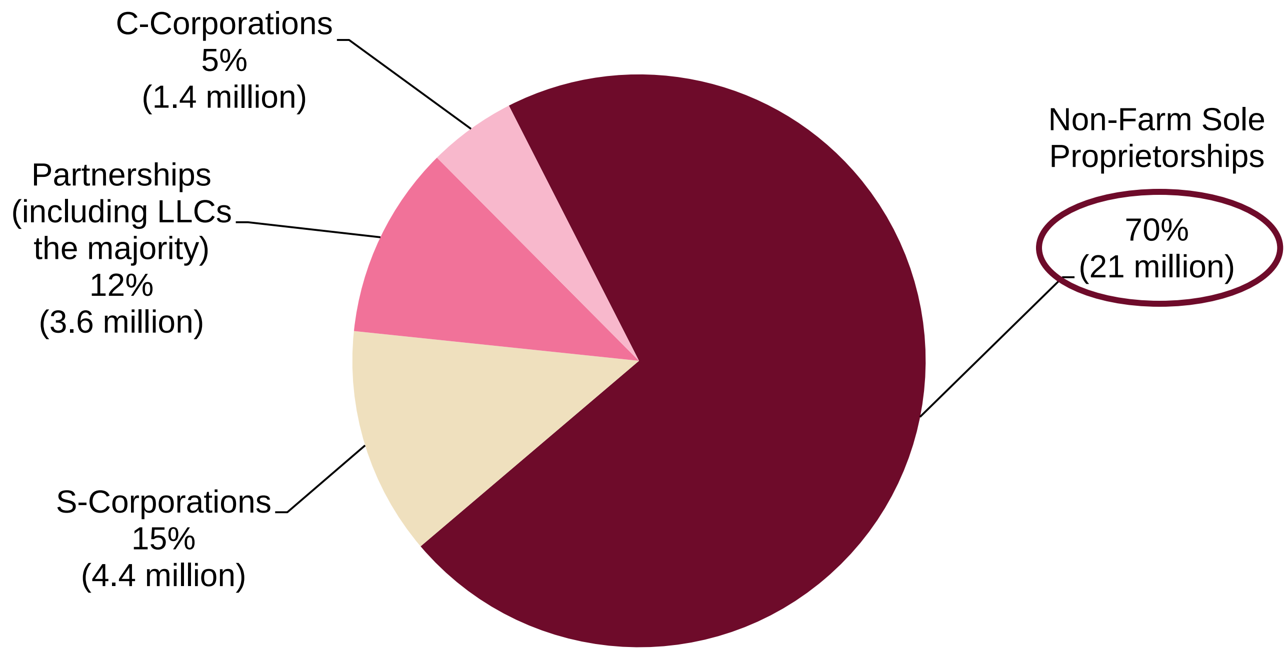
- 80% were non-employer firms (24.3 million) [1]
- 20% were firms w/payroll (5.9 million)[2]:
  - Firms with 0-4 employees made up 61% of these businesses (3.6 million)
  - Firms with < 20 employees made up 90% of these businesses. (5.3 million)
  - Firms with < 500 employees made up 99% of these businesses (5.9 million)
- 53% of all small businesses are home-based.[3]

Source: [1] U.S. Census Bureau; https://factfinder.census.gov/faces/nav/jsf/pages/searchresults.xhtml?refresh=t [2]U.S. Census Bureau; https://www.census.gov/data/tables/2015/econ/susb/2015-susb-annual.html; [3]Small Business Administration; https://www.sba.gov/sites/default/files/advocacy/SB%20Profiles%202014-15_0.pdf

Business Organizations and Tax Structures

- **Sole Proprietorship** - the oldest, simplest and most prevalent business form/ Schedule C submitted to the IRS with IRS Form 1040/SE Tax).
- **Partnership** - an unincorporated organization formed by two or more persons or entities/treated as pass-through entities/IRS Form 1065)
  - General Partnerships (most prevalent);
  - Limited Partnerships;
  - Professional Partnerships; and
- **Corporation** - the most important form of business structure, in terms of total assets. It is considered and artificial entity-separate entity and provides a level of protection against personal liability.
  - C-Corporation – IRS Form 1120 (flat rate of 21%)
  - S-Corporation - a conduit-a pass-through/ IRS Form1120-S)
  - PSC – Personal Services Corporation
- **Limited Liability Company (LLC)** - authorized under state law, similar to Corporations have limited personal liability, but are taxed like a partnership (the majority of all partnerships)

Legal Form of Business Entities



Total 30.2 million private business establishments in the U.S in 2015.
97% are pass-through businesses.[1]

Note: Details do not add to 100.00 due to rounding error
Source: [1] Tax Foundation ; https://files.taxfoundation.org/20170124162950/Tax-Foundation-FF5361.pdf IRS Statistics of Income; SBA http://www.irs.gov/uac/SOI-Tax-Stats-Nonfarm-Sole-Proprietorship-Statisticshttps://www.sba.gov/sites/default/files/advocacy/SB%20Profiles%202014-15_0.pdf

Business Survival

- Statistics about business survival[1]
  - Two-thirds of all businesses survive at least two years
  - Half of all businesses survive at least five years; and
  - One-third of all businesses will survive at least ten years.
- 82% of business failures are due to issues with cash flow.[2]

The 2017 Year End Economic Report*

- More than half of small-business owners feel the national economy is doing better than it was just six months ago, compared to 43 percent who reported the same in Dec. 2016 and the only 20 percent in Dec. 2015.
- One-third of small-business owners saying they are very confident about the future of their own business—the highest this indicator has been in more than 10 years. Overall, 84 percent of small firms expressed confidence in the future of their business.
- Business and job growth also improved. For the first time in a decade, the majority of small firms—53 percent—report increases in revenues. While hiring increased notably, from 22 percent in July 2017 to 30 percent in Dec. 2017, the highest it's been in more than 10 years, it's important to note that the majority of small businesses did not hire new employees in the last year.
- The majority of small-business owners say employees stay with their business four or more years, with 37 percent reporting employees remain on average eight years or more.

Source: *National Small Business Association; 2017 Year End Economic Report; http://nsba.biz/wp-content/uploads/2018/02/Year-End-Economic-Report-2017.pdf

BROKER EDUCATIONAL SALES & TRAINING, INC.

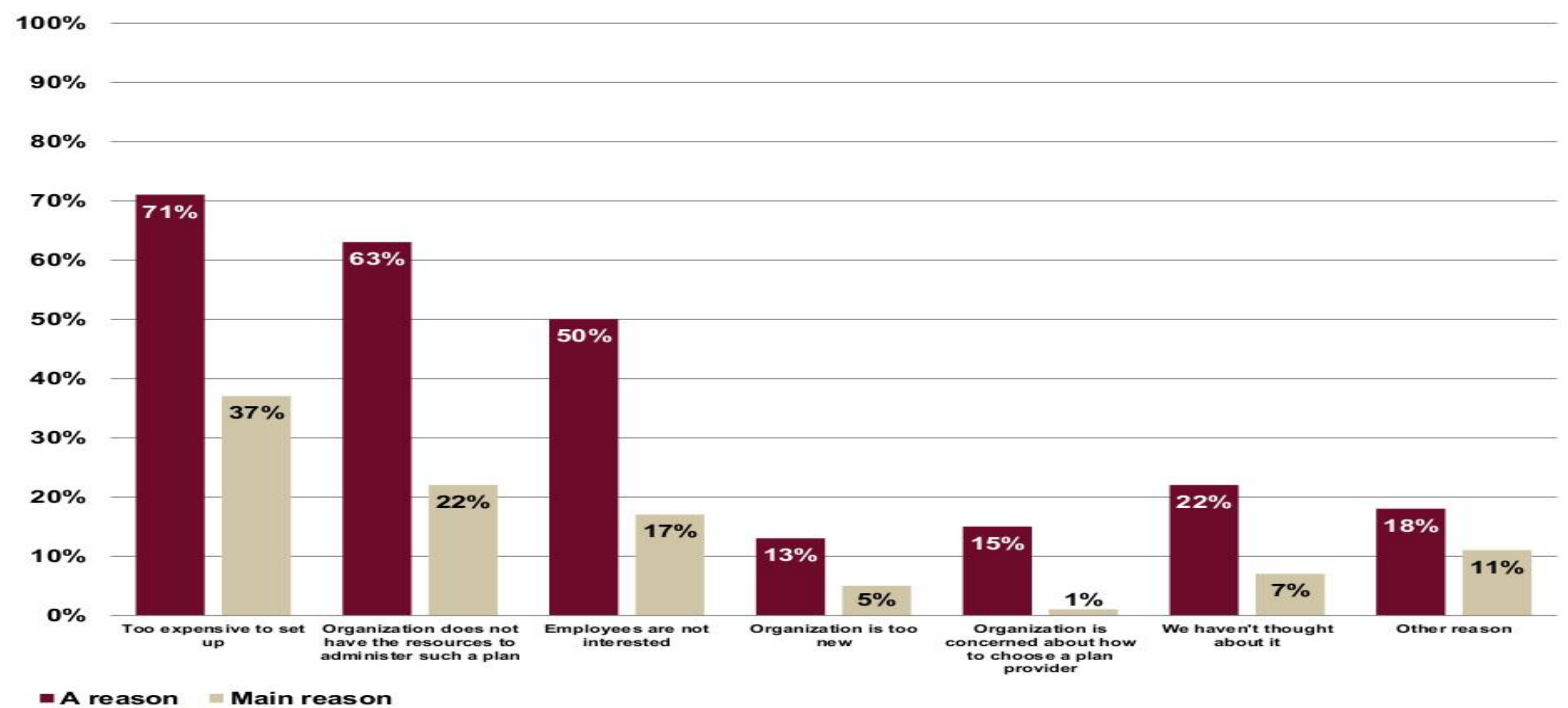
Retirement Plan Sponsorship*

Category	# of Small Businesses	% of Small Businesses	# of SBs Sponsoring A Plan	% of SBs Sponsoring Retirement Programs
Overall U.S. Small Business (2010)	5,343,861	100.0%	735,098	13.8%
Employee Count				
1 to 4	2.8 million	51.9%	151,402	5.5%
5 to 11	1.3 million	24.9%	233,500	17.6%
12 to 25	726,096	13.6%	187,951	25.9%
26 to 100	517,765	9.7%	162,245	31.3%

Source: GAO Report (GAO-13-748T), *Challenges and Prospects for Employees of Small Businesses*, released July 16, 2013; http://www.gao.gov/products/GAO-13-748T.

Why Don't Small-and Medium-Sized Businesses Offer Retirement Plans?

Top reasons: Expenses, administrative burdens and lack of employee interest.



Note: Those without plans were asked to(a) indicate whether any of the following are reasons the organization does not offer a retirement plan (more than one reason can be listed) and (b) Give the main reason for not offering. Source: 2017 Pew Charitable Trust.

BROKER EDUCATIONAL SALES & TRAINING, INC.
B • E • S • T
"Knowledge is Your BEST Investment."

Tax Credit for Setting Up a Retirement Plan

- An eligible ER may claim a tax credit for some of the ordinary and necessary costs of starting a SEP, SIMPLE IRA or qualified retirement plan.[1]
  - The Tax credit is 50% of ordinary and necessary costs up to a maximum of $500 per year. Claim the credit on IRS Form 8881 for each of the first 3 years of the plan (or claim for tax year before plan set up).
    - Set-up and administration costs; and
    - Educate employees about the plan.
- Eligible Employers (ERs):
  - Must have 100 or fewer employees (EEs) who received at least $5,000 in compensation for the preceding year; must have at least one participant who is a NHCE; and in the past 3 years EEs cannot have received contributions or accrued benefits in another plan sponsored by the ER.

Source: [1] IRS Pub.560; https://www.irs.gov/retirement-plans/retirement-plans-startup-costs-tax-credit.

Saver's Tax Credit*

Tax credit available to low and moderate income taxpayers who make contributions to ESRPs.

Credit Rate	Married Filing Jointly	Head of HLD	All Other Filers
50% of contribution	AGI < than $38,001	AGI < than $28,500	AGI < than $19,000
20% of contribution	$38,001-$41,000	$28,501-$30,750	$19,001-$20,500
10% of contribution	$41,001-$63,000	$30,751-$47,250	$20,501-$31,500
0% of contribution	AGI >than $63,000	AGI >than $47,250	AGI >than $31,500

*The maximum tax credit amount in a given year is $1,000/$2,000 (MFJ). To figure out must file IRS Form 8880.

QRPs for Small Business Owners

- Employed Sponsored IRAs
- Defined Contribution Plans
- Defined Benefit Plan
- Combination Plans

Employer Sponsored IRA Plans

- SEP IRA Plan [IRC § 408(k)]
- SARSEP IRA Plan (SBJP Act of 19967)
- SIMPLE IRA Plan [IRC § 408(p)]

SEP IRA Plan*

- Simplified Employee Pensions (SEP) created by The Tax Revenue Act of 1978. Governed by IRC § 408 (k)[1]
  - An agreement between ER and EE to offer a plan in the form of an IRA owned by the EE, and the ER makes the contributions.
- Easy to set up and maintain for any business with or without EEs (IRS Model SEP Form 5305-SEP-IRA Contribution Agreement). No government (IRS) reporting required by ER
- Low start-up and operating costs (eligible for startup tax credit/$500 per year for each of the first 3 years).
- ER can use a calendar year/fiscal year. Used as an alternative/supplement to another qualified retirement plan.

Source: *SEP IRA Plan; https://www.irs.gov/retirement-plans/plan-sponsor/simplified-employer-pension-plan-sep.

SEP IRA ER Contributions

- Employer (ER) contributions (ONLY). No elective deferrals or catch-up contributions. Contributions are discretionary each year, but must be under a written allocation formula [IRC § 408(k)(5)]
  - ER contributions are not subject to FICA or FUTA or income tax WH;
  - ER contributions can be made to an EE over age 70 ½;
  - ER contributions must be 100% immediately vested; and
  - ER contributions do not have to be made until the due date of filing income tax return (including extensions).
- ER contributions cannot discriminate in favor of HCEs [IRC § 408(k)(3)] and must also apply the top-heavy rules.

SEP IRA ER Contribution Limits

- The lesser of: For discretionary ER contributions (2018) up to the lesser of:
  - 25% of pay or $55,000 of the EE's compensation [IRC § 415 (c) (1)(A)].
- Annual Compensation Limit: $275,000 [IRC § 408(k)(a)(3), IRC § 408(k)(6)(D)(ii)].
- Maximum deduction for ER is 25% of covered payroll. Self-employed/ Sole Proprietors : Overall contribution limit is 20% of 92.9% of net profit (that is 18.6% of gross profit)
- Employees, under Traditional IRA rules may make regular annual and catch up contributions to their SEP IRA.

SEP IRA Employee (EE) Eligibility

- Must include all EEs who:
  - Have attained age 21 [IRC § 408(k)(2)(A)],
  - Have been employed 3 of the last 5 preceding years [IRC § 408(k)(2)(B)], and
  - Have earned at least $600 [IRC § 408(k)(2)(C)].
- A SEP may exclude EEs subject to a collective bargaining agreement and non-resident aliens [IRC § 408(k)(2)]

SARSEP IRA*

- A Salary Reduction Simplified Employee Pension established prior to 1997 permits EE elective deferral contributions.
  - Must meet the following participation requirements annually based on all eligible EEs (even those hired after 1996)
    - At least 50% of eligible EEs must choose to make EE salary reduction contributions for the year.
    - Had no more than 25 EEs who were eligible to participate at any time during the preceding year (If an existing SARSEP IRA has more than 25 EEs it must become a SEP IRA-two year grace period).
- Salary reduction limit is the lesser of :
  - 25% of compensation up to annual limit of $275,000, or $18,500 [IRC § 408(k)(6)].
- Plus, catch-up contributions of $6,000 for those eligible participants age 50 and older

Source: *Salary Reduction Simplified Employee Pension Plan; https://www.irs.gov/retirement-plans/plan-sponsor/salary-reduction-simplified-employee-pension-plan-sarsep.

SIMPLE IRA*

- Savings Incentive Match Plan for Employees of Small Employers was created by the Small Business Job Protection Act (SBJPA) of 1996. Governed by IRC § 408(p)[1]
  - Allows for both EE and ER contributions. Avoids all discrimination and top heavy tests
- Easy to set up and administrative costs are low. No financial reporting to the government (No Form 5500).
  - Choice of two forms: IRS Model Form 5304 SIMPLE or 5305-SIMPLE (used with designated financial institution).
- Must be maintained on a calendar year basis only (October 1, new plan)

Source: *SIMPLE IRA Plan; https://www.irs.gov/retirement-plans/plan-sponsor/simple-ira-plan.

SIMPLE IRA Eligibility Rules

- Employer Eligibility:
  - An ER who employs **100 or fewer** EEs who earned **$5,000 or more** during the preceding calendar year [IRC § 408(p)2(C)(i)].
  - The ER can be corporate, non-corporate, tax-exempt, and government entities. The ER cannot offer any other type of qualified retirement plan [IRC §§ 408 (p)(2)(D), 219 (g)(5)].
- Employee Eligibility Rules:
  - Received at least $5,000 in compensation from the ER any 2 preceding years, and are reasonably expected to receive at least $5,000 in compensation during the year [IRC § 408(p)(4)(i) and(ii)].

SIMPLE IRA Contributions Limits

- EE Elective Salary Reduction Contribution (2018):
  - Up to 100% of compensation total to a maximum of $12,500 annually [IRC § 408(p)(2)(E)].
  - Catch-up contributions $3,000 age 50 and older [IRC § 408(p)].
- ER Contributions:
  - Matching Contributions:
    - Up to 3% of employee compensation (downward to 1% in any two years within a 5-year period), or
  - Non-elective contributions
    - 2% of eligible EE's compensation up to maximum of $275,000 ($5,500).
- 100% immediately vested (The "2-Year Rule" 25% penalty)

Note: If an EE participates in any other ER plan during the year and has elective salary reductions under those plans, the total amount of the salary reduction contributions that an EE can make to all the plans he/she participates in is limited to $18,500 in 2018.

Qualified Retirement Plans

- A retirement plan established by employers for their employees that meets the requirements of IRC § 401(a) and is eligible for special tax considerations.
- Two basic types of QRP[1]:
  - DC plans (62/44/72)
  - DB Plans (18/15/81)

Source: [1]Bureau of Labor Statistics, March 2017; http://www.bls.gov/ncs/ebs/benefits/2017/ownership/private/table02a.htm

Defined Contribution Plans

- In 2014 (latest data available) 94% of pension plans were DC plans[1]
  - As of 3rd Quarter 2017, DC plans held $7.8 trillion in assets, representing 28% of the total retirement market and one-tenth of U.S. Households' aggregate financial assets.[2]
- Americans accumulate the vast majority of their retirement funds through employer sponsored defined contribution plans.
  - However, more than 35% of full time workers do not have access to one[3]
- Types of DC plans being used by small businesses:
  - Profit Sharing Plans; 401(k) Plans; Safe Harbor 401(k) Plans; and Individual (Solo) 401(k)

Source: [1]Form 5500 Filings EBSA, September 2016; http://www.dol.gov/ebsa/pdf/historicaltables.pdf; [2]Investment Company Institute (ICI); December 2017; [3]Bureau of Labor Statistics http://www.bls.gov/ncs/ebs/benefits/2017/ownership/private/table02a.htm

Profit Sharing (PS) Plan*

- EEs can be rewarded with a share of the ER's revenue. PS plans offer both design flexibility and the option to make contributions (ER does not need profits).
  - Although there is no fixed annual contribution commitment, ER contribution must be substantial and recurring in order to prevent plan from being terminated by IRS.
- Moderate administration and paperwork; Does require government reporting (Form 5500) and must pass nondiscrimination tests.
  - ER eligible for startup tax credit (only need 1 NHCE to participate).
- Deadline to establish plan is the last day of the ERs tax year; the deadline to fund the plan is the ERs tax filing deadline (including extensions). PS can be combined with a 401(k) plan

Source: *Profit Sharing Plans; https://www.irs.gov/retirement-plans/choosing-a-retirement-plan-profit-sharing-plan.

Profit Sharing Contributions

- Maximum ER contribution (2018): The lesser of:
  - 100% of participant's annual compensation up to $275,000; or
  - $55,000 [IRC § 415 (c)(1)(A)]
    - Note: Top heavy PS plan, ER must make a minimum contribution to non-key EEs equal to the contribution received by any key EE, up to, but not in excess of 3% of compensation.
- ER deductible limit on all ER contributions is 25% of the total of all benefiting EEs' compensation.
- Vesting may be required (6-year graduated or 3-year cliff).
- ER is not required to allow for in-service withdrawals. The ER may include loans, hardship withdrawals or other in-service withdrawal options.

Formulas for Allocating Contributions

- **Pro-rata Method.** This formula is the most basic**.** All eligible participants receive the same contribution rate or specified dollar amount. These allocations are deemed to automatically pass IRS nondiscrimination testing.
- **Permitted Disparity (or Integrated with Social Security).** Designed to favor HCEs. Involves two pro rata allocations:
  - Employee total compensation (pro rata %)
  - Employee compensation above plan's integration level (SSTWB $128,400 in 2018 or some portion of it). Contribution must follow within the IRS's permitted disparity (5.7%) guidelines.
- Example: Business owner A earns $200,000. If the employee makes a 10% contribution on total compensation, Business Owner A would receive $24,081.20

Formulas for Allocation Contributions (cont'd)

- **Age-Weighted Allocation.** Allows the ER to make contributions based on an EEs age as well as compensation.
- **Tiered (or New Comparability or Cross Tested) Allocation.** The most flexible PS formula, it allows an employer to allocate multiple contribution rates to different employee groups (i.e., job classification, title, hourly vs. salaried, etc.) and designates different contribution rates to each employee.
  - To meet nondiscrimination testing must pass a *"general test"* that converts participant contribution rates to a benefit rate at retirement ("cross testing"); and
  - Provide a "*gateway" minimum* contribution to all plan NHCE must equal the lesser of:
    - One-third the highest contribution rate given to any HCE; or
    - 5% of the participant's gross compensation.
  - Maximizes business owner contributions at the lowest total cost

Comparison of PS Allocations

Eligible EE	Age	Compensation	Pro-Rata	Permitted Disparity	Age-Weighted	Tiered
Principal 1	56	$275,000	$55,000 (20%)	$55,000 (20.0%)	$55,000 (20%	$55,000 (20%)
Principal 2	49	$200,000	$40,000 (20%)	$38,400 (19.2%)	$44,000 (22%)	$54,000 (27%)
Principal 3	60	$100,000	$20,000 (20%)	$16,900 (16.9%)	$54,000 (54%)	$54,000 (54%)
Employee 1	59	$90,000	$18,000 (20%)	$15,210 (16.9%)	$45,900 (51%)	$4,500 (5%)
Employee 2	29	$50,000	$10,000 (20%)	$ 8,450 (16.9%)	$2,000 (4%)	$2,500 (5%)
Employee 3	47	$40,000	$ 8,000 (20%)	$ 6,760 (16.9%)	$7,600 (19%)	$2,000 (5%)
Employee 4	32	$30,000	$ 6,000 (20%)	$ 5,070 (16.9%)	$1,800 (6%)	$1,500 (5%)
Employee 5	27	$25,000	$ 5,000 (20%)	$ 4,225 (16.9%)	$1,000 (4%)	$1,250 (5%)
Employee 6	26	$25,000	$ 5,000 (20%	$ 4,225 (16.9%)	$750 (3%)	$1,250 (5%)
Employee 7	23	$25,000	$ 5,000 (20%)	$ 4,225 (16.9%)	$750 (3%)	$1,250 (5%)
Employee 8	69	$20,000	$ 4,000 (20%)	$ 3,380 (16.9%)	$9,800 (49%)	$1,000 (5%)
Employee 9	60	$20,000	$ 4,000 (20%)	$ 3,380 (16.9%)	$11,000 (55%)	$1,000 (5%)
Employee 10	32	$20,000	$ 4,000 (20%)	$ 3,380 (16.9%)	$1,200 (6%)	$1,000 (5%)
Employee 11	35	$20,000	$ 4,000 (20%)	$ 3,380 (16.9%)	$600 (3%)	$1,000 (5%)
Total		**$940,000**	**$187,000**	**$170,985**	**$234,400**	**$180,250**
Principal's Share		**61%**	**61%**	**64%**	**65%**	**90%**

Note: All allocation methods are governed by top-heavy and nondiscrimination rules.

401(k) Plans*

- A DC plan [IRC § 401(a)], created by The Tax Revenue Act of 1978, effective for plan years beginning January 1, 1980.
  - Set up by any type of employer including tax-exempt organizations.
- 401(k) plans have grown to be the most widespread private sector ER sponsored retirement plan in the U.S., representing the largest number of participants and assets.
  - As of the 3rd Quarter of 2017, $5.3 trillion was held in 401(k) plans[1]
- Used as sole retirement plan or as a supplement to an existing plan.

Source: *401(k) Plans; https://www.irs.gov/retirement-plans/401k-plans. [1]Investment Company Institute, December 2017 https://www.ici.org/research/stats/retirement/ret_17_q3.

401(k) Contribution Limits

- Employee Elective Deferrals (Traditional/DRAC)
  - $18,500 in 2018 [IRC § 402(g)]
- Catch-up contributions for participant age 50 and older is:
  - $6,000 [IRC § 414(v)(2)(B)(i)] Cannot be placed in DRAC
- Matching contributions
  - When factoring in matching contributions the maximum allowable contribution may not exceed the lesser of:
    - 100% of compensation up to $275,000; or
    - $55,000 [IRC § 415(c)(1)(A)].
- Must meet nondiscrimination testing rules

Nondiscrimination Testing Rules

- Broad Coverage of Employees – minimum participation standards concerning coverage of EEs [IRC § 410(b)]
  - **Ratio percentage test:** Plan must benefit at least 70% of NHCE
  - **Average benefit test**: Nondiscriminatory classification test and the average benefit test.
- Benefits, Rights and Features - elective contributions, matching contributions, and EE after-tax contributions must meet special nondiscrimination tests.
  - **Actual Deferral Percentage (ADP)** – applies to EE elective deferral contributions (must meet either the 1.25 times test or the 2+2 test); and
  - **Actual Contribution Percentage (ACP**) – Applies to ER matching and EE after tax contributions (same tests as ADP)
- Top Heavy Test - 60% of the overall assets in the plan are attributable to key employees

Definitions

- Highly Compensated Employee (HCE) IRC § 414(q)(1):
  - A 5% owner, as defined in IRC § 416(i)(1), or EE received compensation for the preceding year in excess of $120,000 in 2018 ($120,000 if preceding year is 2017) [IRC § 414(q)(1)(B)], and in the "top-paid group" for the preceding year".
- Key Employee
  - A more than 5% owner of the business;
  - An officer making over $175,000 [IRC 416(i)(A)(1)];
  - An employee owning more than 1% of the business and making over $150,000 [IRC §416(i)].

401(k) Safe Harbor Plans

- The Small Business Job Protection Act (SBJA) of 1996 introduced the Safe Harbor provisions (contributions) to avoid the nondiscrimination testing (ADP/ACP) and the top heavy rules.
  - These contributions may be employer matching contributions, limited to employees who defer, or employer contributions made on behalf of all eligible employees, regardless of whether they make deferrals (Non-elective Contributions).
- Notice Requirements: Each eligible employee must be given written notice of the employee’s rights and obligations under the plan and the notice satisfies the content and timing requirements [IRC § 401(k)(12)(D)]
- 68% of small business plans use a Safe Harbor 401(k) plan design.[1]

Source:[1] https://www.employeefiduciary.com/blog/401k-plan-design-study-what-2767-small-business-401k-plans-are-doing http://uscode.house.gov/view.xhtml?req=(title:26 section:401 edition: prelim) OR (granuleid:USC-prelim-title26-section401)&f=treesort&edition=prelim&num=0&jumpTo=true#substructure-location_k_13

Safe Harbor Contributions

- Alternative Methods of meeting nondiscrimination requirements [IRC § 401(k)(12)]:
  - **Matching Contribution:** A dollar for dollar match on elective contributions up to 3% of compensation and a 50 cents-on the-dollar match on elective contributions between 3% and 5% of compensation (max 4%) [IRC § 401(k)(12)(B)(i)].
  - **Non-elective Contribution:** the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution on behalf of each employee who is not a HCE and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation [IRC § 401(k)(12)(C)].
- These contributions are non-discretionary (required) contributions. They must be subject to 100% vesting.

Safe Harbor Contributions (cont'd)

- Alternative Methods of meeting nondiscrimination requirements : Qualified Automatic Contribution Arrangements (QACA) [IRC § 401(k)(13)]:
- Minimum levels of EE and ER contributions:
  - Automatic EE Contributions (AEC): The initial AEC must be at least 3 percent of compensation. Contributions may have to automatically increase so that, by the 5th year, the AEC is at least 6% of compensation. AEC cannot exceed 10%.
  - ER Contributions: Either A matching contribution of 100% for salary deferrals up to 1 percent of compensation and a 50 percent match for all salary deferrals above 1 percent but no more than 6 percent of compensation; or A non-elective contribution of 3 percent of compensation to all participants.
- QACA contributions may be subject to a 2 year cliff vesting schedule

401(k) Plan Design*

- Only 8.71% of plans automatically enroll employees that fail make an affirmative enrollment decisions;
- 65.96 of plans permit after-tax DRAC contributions;
- 64.37% of plans permit non-Safe Harbor employer matching contributions;
- 85.65% of plans permit employer profit sharing contributions; and
- A new comparability profit sharing contribution is most commonly combined with a Safe Harbor 3% non-elective plan design.

Source: 401kPlan Design Study: What 2,767 Small Business 401k Plans Are Doing; December 2016; https://www.employeefiduciary.com/blog/401k-plan-design-study-what-2767-small-business-401k-plans-are-doing.

Who might benefit most from a Safe Harbor Plan?

- Employers who are planning to or who already make a comparable matching contribution.
- Employers whose plans are top-heavy at least 60% of plan assets are in the accounts of key employees).
- Employers with relatively low employee turnover.
- Companies with fewer employees (where large percentage are defined as key employees).
- Companies whose HCEs are interested in contributing more to the plan and whose elective deferrals would be or have been significantly limited.
- Companies seeking to limit the time and money spent on plan testing.

BROKER EDUCATIONAL SALES & TRAINING, INC.
B · E · S · T
"Knowledge is Your BEST Investment."

Vesting

Refers to the extent to which a participant's interest in a 401(k) plan is non-forfeitable [IRC § 411]. Any portion of that interest that is not vested is subject to possible forfeiture.

Contributions Subject To 100% Vesting

- Elective Contributions;
- Qualified Matching Contributions (QMACs)
- Qualified Non-elective Contributions (QNECs)
- After-Tax EE Contributions
- Rollover Contributions
- Safe Harbor 401(k) plans and Non-Elective and matching contributions in a SIMPLE 401(k) plan.

Contributions Not Subject To 100% Vesting:

- Non-elective contributions; and
- Matching contributions

Vesting Schedules

- 2/20 Graded Six-Year Vesting
  - 2 = 20
  - 3 = 40
  - 4 = 60
  - 5 = 80
  - 6 or more = 100
- 3 Year Cliff Vesting:
  - Fewer than 3 = 0
  - 3 years or more 100%

Individual (Solo) 401(k)*

- Designed for owner-only businesses (not available to businesses with EEs)
  - Owners and immediate family members
  - Owners with part-time or seasonal EE who can be excluded from the plan.
- Eligible Businesses can be incorporated (partnerships and corporations) and unincorporated (sole proprietorships)
- Simple to administer and low costs-no set up fee or annual administrative charge to ER. Must file 5500-SF if assets in the plan are over $250,000.
- High contribution limit (with DRAC 401(k) feature)
- Access to account: Loans and hardship withdrawals

Source: *One-Participant 401(k) Plans; https://www.irs.gov/retirement-plans/one-participant-401k-plans.

Individual (Solo) 401(k) Contributions

- Employee Elective (salary reduction):
  - 100% of EE's compensation up to $18,500 [IRC § 402(g)].
- Catch-up Contributions:
  - Additional $6,000 in salary deferrals for individuals age 50 and older
- Overall maximum limits:
  - The lesser of 100% of compensation up to $275,000; or $55,000 [IRC § 415] plus catch-up contribution ($6,000) = $61,000 for 2018.
- ER deductible contributions:
  - Up to 25% of compensation (payroll)

Defined Benefit Plan*

- Provides a fixed, pre-established benefit for each employee at specified event (NRA ages 62-65, plan termination).
- Primarily funded by ER, who is generally required to make contribution as set by plan term. An actuary must determine annual contributions.
  - Maximum retirement benefit is 100% of compensation up to a maximum of $220,000 a year [IRC § 415(b)(1)(A)].
- Any type of organization that is eligible to establish a QRP is eligible to establish a DB plan; Costly to administer and must file annual Form 5500. May vest over time according to plan terms.
- Pension Benefit Guaranty Corporation (PBGC) provides insurance protection for the retirement income of participants and beneficiaries in most DB plans only (Title IV of ERISA).
  - In 2018, for a retiree age 65, $65,045.00 of income protected by PBGC.

Source: *Defined Benefit Plan; https://www.irs.gov/retirement-plans/defined-benefit-plan.

Traditional DB Funding Benefit

- There are several types of formulas for determining the DB benefit. The most common formulas are:
  - Flat Amount Formula (stated dollar amount)
  - Flat Percentage of Earnings Formula (most common)
  - Unit Credit Formula (EE service and compensation)
- Computing Average Earnings
  - Career Average Method (earnings average over entire career)
  - Final Average Method (average over the last 3-5 years prior to retirement)
- Integration with Social Security
  - Integrating the formula with SS gives the ER some credit for paying the cost of EE SS benefit.

Traditional Defined Benefit Rules

- Participation (non-discrimination) Tests:
  - Some plans may cover all EEs who are 21 and have worked at least 1,000 hours in a previous year [IRC § 401(a)(1)].
- Minimum coverage test when plans are limited to certain groups of EEs (e.g. salaried EEs, EEs within certain divisions) [IRC § 410(b)]:
  - **Ratio Percentage Test:** The plan benefits at least 70 percent of the eligible EEs who are NHCEs receive benefits.
  - **Average Benefit Percentage Test:** Is two tests (1) The plan must benefit a classification of EEs that does not discriminate in favor of HCEs (nondiscriminatory classification test) and (2) the average benefit percentage of the NHCEs must be at least 70 percent of the average benefit percentage of the HCEs.
- 50/40 Test: The DB plan must benefit 50 or more EEs; or 40 percent of all employees [IRC § 401(a)(26].

Hybrid DB Plans

- Hybrid plans were developed to meet the needs of workers who hold a number of jobs throughout their live [IRC § 411(a)(13(C)].
- Types of Hybrid DB Plans:
  - Cash Balance Plans (Defines a benefit in terms that are more characteristic of a DC plan);
  - Pension Equity Plans (define benefits in terms of a current lump-sum value).
  - Life Cycle or Retirement Bonus Plans (a final average salary pension plan); and
  - Floor-Offset Pension Plans (“Feeder: Plan two separate plans).
- Fully Insured DB Plan (defined in IRC § 412(e)(3), formerly known as Section 412(i) plans benefits guaranteed by an insurance company).

Cash Balance Plans

- Cash balance plans are the fastest-growing part of the DB pension universe[1]:
  - 92% of Cash Balance Plans are in place at firms with fewer than 100 employees and they make up over 34% of all defined benefit plans
  - The number of Cash Balance Plans increased 17% compared with just 3% growth in 401(k) plans in 2016.
- Reasons for growth of Cash Balance Plans:
  - Rising taxes;
  - Hybrid appeal;
  - Legislative changes and broader options for plan sponsors; and
  - Retirement savings crisis.

Source: Kravitz 2017 National Cash Balance Research Report; https://cdn.cashbalancedesign.com/wp-content/uploads/2017/08/NationalCashBalanceResearchReport2017.pdf.

Cash Balance (CB) Plans

- A DB plan that looks like a DC plan. PPA of 2006 greatly expanded their legitimacy [IRC § 411(a)(13)(A)]
  - Participants are divided into groups by classifications, similar to a New Comparability PS plan.
- Benefits = Contribution and interest credits. Typically double the contribution employees receive with 401(k) plans.
  - 100% ER funded
  - Calculated actuarially and are mandatory
- Require employers to contribute 5% to 8% of pay to NHCE in order to contribute larger amounts for the owners
- Plan assets are pooled and Trustee directed. ER bears the burden of risk. Vesting: 100% of ER contributions after 3 years of employment (based on lump sum benefit)

Cash Balance Plan vs. Traditional DB

Census Data			Traditional DB Plan		Cash Balance Plan	
Position	**Age**	**Annual Pay**	**Cost Allocation**	**% of Pay**	**Cost Allocation**	**% of Pay**
Owner A	55	$275,000	$162,250	59%	$159,500	58%
Owner B	50	$275,000	$132,000	48%	$115,500	42%
EE 1	50	$75,000	$47,250	63%	$13,500	18%
EE2	55	$50,000	$39,000	78%	$9,000	18%
EE 3	35	$40,000	$10,000	25%	$7,200	18%
EE 4	30	$35,000	$6,650	19%	$6,300	18%
EE 5	25	$30,000	$4,500	15%	$5,400	18%
		Owners	$294,250	**73% to Owners**	$275,000	**87% to Owners**
		Employees	$107,400		$41,400	
		Total	$401,650		$316,400	

[1]Assumes a benefit based on 10% of average monthly compensation multiplied by a maximum of ten years of participation, and a Target Normal Cost calculated using mandated segment rates. Analysis by author.

Prospects for Cash Balance Plans[1]

- Healthcare
  - Medical and dental groups account for 37% of all Cash Balance Plans nationally.
- Technical;
- Legal; and
- Financial Sectors.

Source: Kravitz 2017 National Cash Balance Research Report; https://cdn.cashbalancedesign.com/wp-content/uploads/2017/08/NationalCashBalanceResearchReport2017.pdf.

Combination Plans

- IRC § 414(x) allows an eligible small employer to maintain both a DC plan and a DB plan.
  - An eligible employer is a small employer who employed an average of fewer than 500 employees during the preceding calendar year [IRC § 414(x)(2)(A)].
- IRC § 414(x)(6)(A) the requirements applicable to DB pension plans with separate participant accounts, do not apply to eligible combined plans.
- Combination plans allow small business owners to optimize tax efficiency and maximize retirement savings.

Safe Harbor Formula

- Minimum Contributions for DC Plan (401(k) Plan):
  - Automatic enrollment for the 401(k) component. Unless an EE specifically opts out, or changes the contribution level, then 4% of their pay is automatically contributed into 401(k) plan.
  - An ER match of at least 50% of EE 401(k) contributions, with a maximum required match of 2% of pay. ER non-elective contributions are allowed
- Minimum Contributions for DB Plan:
  - A DB plan equal to 1% of final average pay for each year of the employee's service, up to 20 years, or a cash balance formula as follows:

Age	Contribution Credit
30 or less	2%
Over 30 and less than 40	4%
Over 40 and less than 50	6%
50 and over	8%

- All ER derived benefits under the DB component and the non-elective contribution under the DC component would have to be fully vested within three years.

Census Data			Safe Harbor and 401(k) Profit Sharing Plan				Cash Balance Plan		Combined Total
Position	**Age**	**Annual Pay**	**Salary Deferral**	**3% SHNEC**	**Cross-Tested PS**	**Total % of Pay**	**Cost Allocation**	**% of Pay**	
Owner A	55	$275,000	$24,500	$0	$8,250	3%	$148,500	54%	$173,000
Owner B	50	$275,000	$24,500	$0	$8,250	3%	$148,500	54%	$173,000
EE 1	50	$75,000	$0	$2,250	$3,750	8%	$1,500	2%	$7,500
EE 2	55	$50,000	$0	$1,500	$2,500	8%	$1,000	2%	$5,000
EE 3	35	$40,000	$0	$1,200	$2,000	8%	$800	2%	$4,000
EE 4	30	$35,000	$0	$1,050	$1,750	8%	$700	2%	$3,500
EE 5	25	$30,000	$0	$900	$1,500	8%	$600	2%	$3,000
		Owners	$49,000	$0	$16,500		$297,000		$346,000
		EEs	$ 0	$6,900	$ 9,500		$4,600		$ 23,000
		Total	$49,000	$6,900	$26,000		$301,600		$369,000
								Percent to Owners	**94%**

Keogh Plans

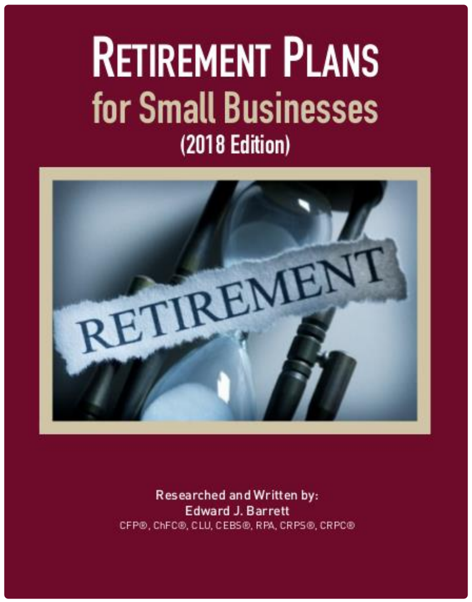
- HR-10 is a qualified retirement plan that can be either a DC or a DB plan. It covers one or more self-employed individuals [IRC § 401(c)].
  - A self-employed individual is a sole proprietor or partner who works in his or her unincorporated business (Sch. C).
- "Earned income" takes the place of compensation.
  - Self-employment net income after all deductions, including the deduction for plan contributions, and ½ of self-employment tax.
    - If the nominal rate is 25%, the net contribution rate is 20% [IRC § 401(c)(2)].
- Contributions limited to the lesser of:
  - $55,000; or 100 percent of the participant's earned income for the year.
- Plan must be set up by the end of year, but contributions do not have to be made up until the due date of the return (including extensions).


The End

Survey

Need More CE?

Browse our course catalog at http://selfstudyce.brokered.net and let us help you fulfill your mandatory CE requirements.



To place an order
Call 1-800-345-5669 and ask to speak with a Self-Study Customer Service Representative or send an email to self_study@brokered.net.

State	Hours	State	Hours	State	Hours
Alabama	20	Kentucky	12	North Dakota	20
Alaska	14	Louisiana	16	Ohio	10
Arizona	20	Maine	20	Oklahoma	18
Arkansas	20	Maryland	20	Oregon	8
California	17	Massachusetts	20	Pennsylvania	20
Colorado	20	Michigan	20	RhodeIsland	8
Connecticut	20	Minnesota	20	South Carolina	20
Delaware	20	Mississippi	16	SouthDakota	10
DC	20	Missouri	16	Tennessee	20
Florida	20	Montana	20	Texas	12
Georgia	20	Nebraska	20	Utah	12
Hawaii	20	Nevada	20	Vermont	20
Idaho	20	New Hampshire	20	Virginia	20
Illinois	12	New Jersey	20	Washington	2
Indiana	12	New Mexico	15	West Virginia	12
Iowa	18	New York	15	Wisconsin	20
Kansas	12	North Carolina	20	Wyoming	20
CFP	5 & 10	CIMA/CPWA	5 & 10		

Asked@brokered.net