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Maximizing Retirement Benefits for Key Employees

401(K) PLANS, BENEFITS, PROFESSIONAL SERVICES
BY JASON LUMPKIN

As a general rule, the Internal Revenue Code requires that a qualified retirement plan cannot discriminate in favor of highly compensated employees (HCEs) with respect to the amount of contributions or benefits provided by the plan. In a defined contribution plan, such as a 401(k) plan with a profit sharing plan component, this determination is usually made with respect to the *current amount* of contributions provided to the HCEs when compared to the contribution provided to the non-highly compensated employees (NHCEs). Many profit sharing plans automatically satisfy the nondiscrimination requirements by providing all employees with the same contribution rate, which is an allocation method that is pre-approved by the Internal Revenue Service, since it provides all employees with the same contribution rate as a percentage of compensation.

As an alternative to measuring contributions as a percentage of compensation, a defined contribution plan may also be tested with respect to the contribution's "equivalent benefit" provided to each employee at retirement age, similar to a defined benefit plan. This is commonly referred to as cross-testing.

Cross-testing enables a 401(k) or profit sharing to provide higher contribution rates to certain employees, such as owners and/or other key employees, regardless of whether they may be highly compensated or non-highly compensated participants, as long as the allocations satisfy the aforementioned cross-testing requirements. Because cross-testing compares the future value of current contribution amounts at each employee's retirement age, it is ideal for contribution models that intend to provide comparatively higher contribution amounts to older employees, which are often business owners and upper management, allowing plan sponsors to potentially maximize retirement benefits for targeted employees.

A properly designed cross-tested 401(k)/profit sharing plan provides considerable flexibility, both in terms of structure and funding. A plan can establish a number of different groups of employees (each employee can actually represent his/her own group), all of which can be assigned a different contribution rate within applicable annual limitations. Also, unlike a defined benefit plan with minimum funding requirements as prescribed by law, a defined contribution plan is typically designed with "discretionary" company contributions, allowing the plan sponsor to determine what amount, if any, will be contributed to each group, each plan year.

For additional information regarding cross-testing or other plan design alternatives, please contact Jason Lumpkin of SD*Advantage* Retirement Solutions, LP.

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