HERITAGE

New Opportunities For Large Groups

Traditionally, companies have had the option of adopting either a Defined Contribution Plan, such as a 401(k) Profit Sharing Plan or a Defined Benefit Plan. Each of these types of plans has advantages and disadvantages to the employer and employees. This article will focus on the advantages and disadvantages of certain plans from the employer's perspective.

Combined plans have always been available to companies but few employers utilized a dual plan strategy because of the overall plan limitations. Section 404(a)(7) of the Internal Revenue Code limited the total contribution made to both plans to 25% of eligible payroll. This is the same limit that applies to a stand-alone Profit Sharing Plan. In other words, there was no incentive for companies to offer dual plans when they could achieve the same tax-deduction using one. Obviously, one plan requires less cost and time to administer and is less complex to communicate to employees. In addition, Profit Sharing Plans offer more flexibility than traditional pension plans.

The Pension Protection Act of 2006 amended Section 404(a)(7) of the code. With this revision, opportunities were created. Under the new rules, the limitation for combined plans has been relaxed. In 2017, employers can fully fund a defined benefit plan, make salary deferrals to a 401(k) plan and fund their profit sharing plan up to 6% of compensation[1].

This means that companies no longer need to make trade-offs when choosing a retirement plan. They can take ad- vantage of the large tax deductions afforded by a defined benefit plan and still keep the flexibility of a defined contribution plan. The cost of retirement and the investment risk is shared with employees in the 401(k) profit sharing plan. The employer assumes the investment risk in the defined benefit plan. Disadvantages of stand-alone plans are minimized when running a combined or paired plan. As a result, the benefits are maximized when combining a paired plan.

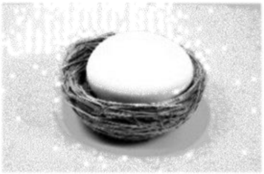
A paired plan maximizes tax deductions to the owner, while also creating wealth working in a tax preferred environment. The plan also serves to attract, retain and reward key employees. Furthermore, with proper planning, a paired plan can help the continuation of the business and facilitate the transfer of the estate for the business owner.

The Cash Balance Advantage Rules & Regulations

A Cash Balance Plan is more evenly funded because it is based on a Career Average Pay scale. In this way, sharp spikes in income that may occur as an employee approaches retirement will not have as big of an impact on the employer cost as it would under a traditional plan.

Cash Balance Plans offer unique advantages over traditional defined benefit plans. First, they "look'' very similar to 401(k) plans. Employees receive an employer contribution equal to a set percentage of their pay deposited into a pooled account.

Employees are guaranteed a set rate of return on this account as dictated by the plan. At year end, they will receive a statement that shows a beginning balance, an employer contribution, a return on their account and an ending balance.



1: Section 404(a)(7) of the Internal Revenue Code as amended by PPA

Codes can be found at: https://www.irs.gov/tax-professionals/tax-code-regulations-and-official-guidance

Phone: 888-863-6853 Fax 631-423-9656

The benefit is plain and simple to understand and is appreciated. Another advantage that cash balance plans offer is the ability to equalize the contribution for partners.

Under a traditional defined benefit plan one of the big- gest factors in determining the cost of an employee's benefit is his/her age. Since partners are often of various ages, contributions are skewed toward the older partners.

This may potentially create resentment from the younger partners and stop the plan design altogether. With a cash balance plan, we can create tiers of employees. As long as the nondiscrimination test passes, we can allocate different amounts of contribution to the various tiers of employees.

Not every employee must benefit under a Cash Balance and Profit Sharing plan. Under IRS rules, there is an objective test that compares the percentage of Non Highly Compensated Employees (NHCEs) covered under the Plans to the percentage of Highly Compensated Employees (HCES) covered under the Plan.

If the '70% ratio test' is satisfied, then the Plan passes the coverage requirements. A Highly Compensated Employee for 2017 is an employee who earned over \$120,000 in 2016[2]. When you have many employees who earn more than \$120,000, and you exclude them from the plan, it becomes much easier to pass the ratio test and maximize deductions to the owners.

Combination plans can work for many types of businesses both large and small. For companies already sponsoring a 401(k) plan, a Cash Balance Add-on may be the perfect solution to their retirement and tax planning goals

Example: ABC Law Firm

50 Partners	If you exclude the 50 associates of ABC Law Firm from the plan, then you only need to include 18 of the 50 staff in the plan and you can include all the 50 partners in the plan.
50 Associates (all earning over \$120,000 in 2016)	70% Ratio Test: 18/50 NHCES benefit = 36%, 50 of 100 HCES benefit = 50% Since 36% / 50% = 72%, which is >70%, this Plan design passes the Ratio Test[3]
50 Staff	This plan also passes the 'minimum coverage requirements' of IRS rules. Regardless whether they are HCEs or NHCEs, you must benefit the lesser of 40% of 50 employees[4]. For a group of 150 employees, this would be 50 employees (lesser of 50, or 40% of 150 [60]). Since the ABC Law Firm Cash Balance Plan will cover 68 participants, the minimum coverage requirements are satisfied.

2: Section 414 (q)(1)(b) of the Internal Revenue Code.
3: Section 410 (b) of the Internal Revenue Code.
4: Section 401 (a)(26) of the Internal Revenue Code.

Consult your accountant and/or attorney regarding the tax and financial implications of the program. Heritage Administrative Services and their employees, as well as the insurance company illustrated, do not provide tax, accounting or financial planning advice. Benefits and contributions are subject to change if mandated by revisions of the Internal Revenue Code and/or IRS regulations. Heritage Administrative Services is an independently owned third party administration firm with no affiliation with any insurance carrier or broker/dealer.

Codes can be found at: https://www.irs.gov/tax-professionals/tax-code-regulations-and-official-guidance

Phone: 888-863-6853 Fax 631-423-9656