

Retirement Planning Opportunities

Do Your Clients Need Higher Tax Deductions in 2008? Set Up Profit Sharing Plans to go with Their Defined Benefit Plans

New Opportunity – Employers Can Now Sponsor Both a Maximum Defined Benefit Plan and a Profit Sharing Plan

Thanks to the Pension Protection Act employers can now sponsor both a maximum defined benefit plan and a profit sharing plan. Previously it was very difficult for employers to have both plans so this is a new opportunity for most employers and will help them increase their tax deductions and retirement benefits.

The Deduction Limit for Multiple Plans Before the Pension Protection Act

The Pension Protection Act changed the deduction limit for employers who are sponsoring both a defined benefit and a defined contribution plan.

Before this legislation the rule was simple. If an employer sponsored both a defined benefit and a defined contribution plan, and there were any employees in both plans, then the maximum deduction he could take for both plans was the greater of:

- 25% of the plan payroll or
- the amount required to fund defined benefit plan.

Usually when employers set up defined benefit plans, they do so because they want to contribute and deduct more than 25% of the plan payroll. However, if the contribution to the defined benefit plan was over 25% of the plan payroll, then no employer contributions were deductible to a defined contribution plan.

Exception for Salary Deferrals

The only exception to this rule in the past was for the employee salary deferrals. These were not included in the deduction limit so an employer could contribute 25% of payroll to a defined benefit plan plus he or she could defer the maximum (\$15,500 if under age 50 and \$20,500 if age 50 or older in 2008*) to a 401(k) plan.

*Max. deferral allowed in 2008. Max. indexed and may increase in the future.

Maximum Defined Benefit Plan & Maximum Profit Sharing/401(k) Plan

	Age	Salary	Fully Insured*	Profit Sharing 401(k)	Total Both Plans
Owner	52	230,000	368,720	51,000	419,720
A	36	39,520	22,354	1,976	24,330
B	34	42,078	21,349	2,104	23,543
C	20	27,040	7,336	1,352	8,688
Totals			\$419,759	\$56,432	\$476,281

*Figures assume the maximum benefit and contribution allowed under the applicable provisions of the Internal Revenue Code. These figures may change in the future since the applicable limits are adjusted for inflation annually. The 412(i) plans use a death benefit based on Revenue Ruling 74-307 & Guardian's Pension Trust Whole Life 100 (PT WL 3- Preferred) and Annual Premium Deferred Annuity (PT APRA-3B).

Pension Protection Act - Deduction Limit Changes

The Pension Protection Act changed the limit on deductible contributions for employers who sponsored both defined benefit and defined contribution plans by adding two more exceptions to the rule. These exceptions will allow almost any employer with a defined benefit plan to set up a profit sharing plan in addition to the defined benefit plan. It may be time to talk to some of your clients with defined benefit plans about this new option.

Exceptions to Deduction Limit

The following are exceptions to the deduction limit for businesses that sponsor both a defined benefit and a defined contribution plan:

- 1) Employee deferrals are still excluded from the combined plan deduction limit and can be made on top of other contributions.
- 2) Now, defined contribution plans with employer contributions of 6% of payroll or less are also excluded from the deduction limit.
- 3) And contributions to defined benefit plans

that are subject to the Pension Benefit Guaranty Corporation (PBGC) are also excluded from the deduction limit.

Which Plans Are Subject to the PBGC?

Most defined benefit plans are subject to the PBGC, but there are two fairly common exceptions. These are plans covering only the business owners and spouses and plans of professional service corporations with no more than 25 lives.

Neither of these types of plans are subject to the PBGC so, if they have a maximum defined benefit plan, then the employer contributions in any profit sharing plans they set up must be limited to no more than 6% of the plan payroll.

Plans Subject to the PBGC - Maximum Defined Benefit with Maximum Profit Sharing Plans

In the example shown above, the business owner Sue has a defined benefit plan that is subject to PBGC so she is able to sponsor both a maximum defined benefit plan and a maximum profit sharing plan.

Since she is age 50, she is able to have the

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maximum possible contribution in the profit sharing plan -- \$51,000. And since she is using a New Comparability profit sharing/401(k) plan formula, she is able to limit the contribution to her employees to just 5% of their salaries. Sue ends up getting 90% of the profit sharing plan contribution going to herself.

New Comparability profit sharing/401(k) plans are very sensitive to the plan demographics. If this census was different, then the business owner might get less or the rank and file employees might get more, but when it works perfectly as it does in this example, the figures are almost unbeatable.

Setting up a maximum profit sharing plan can allow business owners to substantially increase their business's tax deduction and their own retirement benefits.

6% of Payroll Limit – Possible Dream Plan

Those businesses limited to spending just 6% of the plan payroll in their profit sharing plans may be able to design a "dream plan". A Safe Harbor 401(k) Plan with matching contributions may, in some instances, allow the business owners to set up profit sharing plans where the only contributions are for the business owners and no contributions are required for the rank and file employees.

6% of Payroll Limit - Safe Harbor 401(k) Plan with Matching Contributions

In the example above, the business owner Fred has a Safe Harbor 401(k) Plan with matching contributions along with his Fully Insured Plan. With most 401(k) plans, Fred's deferral would be limited to no more than a small percentage above the average deferred by his non-highly compensated employees due to a nondiscrimination test known as the ADP test.

With a Safe Harbor 401(k) plan Fred can defer as much as he wants regardless of what his employees defer as long as he makes the safe

Safe Harbor 401(k) with Matching Contributions Contribution Limit of 6% of Payroll

	Age	Salary	Fully Insured*	Deferral	401(k) Contrib.	Total	Total Both Plans
Owner	52	230,000	368,720	20,500	9,200	29,700	398,420
A	36	39,520	22,354	0	0	0	22,354
B	34	42,078	21,349	0	0	0	21,349
C	20	27,040	7,336	0	0	0	7,336
Totals			\$419,759	\$20,500	\$9,200	\$29,700	\$449,459

*Figures assume the maximum benefit and contribution allowed under the applicable provisions of the Internal Revenue Code. These figures may change in the future since the applicable limits are adjusted for inflation annually. The 412(i) plans use a death benefit based on Revenue Ruling 74-307 & Guardian's Pension Trust Whole Life 100 (PT WL 3- Preferred) and Annual Premium Deferred Annuity (PT APRA-3B).

harbor matching contribution. The matching contribution is:

- 100% of the first 3% of salary deferred &
- 50% of the next 2% of salary deferred

Since this safe harbor 401(k) plan is also exempt from top-heavy contributions, Fred does not have to make any contribution at all for any employees who do not make any deferrals.

In his Safe Harbor 401(k) Plan with matching contributions, Fred can defer the maximum of \$20,500 and also give himself a matching contribution of \$9,200 for a total contribution of \$29,700. Since none of his employees made salary deferrals, Fred does not have to any contributions for his employees.

So Fred's contribution for himself of \$29,700 is the only contribution going into the plan. Fred, the business owner, is getting 100% of the plan contribution and his employees are getting nothing.

Fred is, therefore, able to increase his contribution by \$29,700 without any cost for including the other employees.

Cautionary Notes: If his employees do make deferrals, he will have to give them matching contributions. But these matching

contributions are, at most, 4% of each employee's salary so this plan can be very economical, particularly if the employees are young and low paid and, therefore, unlikely to make deferrals.

It is also important to remember that if the business owner makes any contributions aside from the deferrals and the match, he may have to make additional contributions for his rank and file employees.

Action Plan for Higher Tax Deductions - Review Your Clients' Defined Benefit Plans

Please feel free to contact me if you would like help in reviewing your clients' defined benefit plans to see if they can take advantage of the opportunities now available from the Pension Protection Act and some other recent pension legislation.

You may be able to increase your clients' tax deductions and their retirement assets by setting up new profit sharing plans or by redesigning the plans they already have.

In some cases they may even be able to set up plans where the business owners are the only participants who receive contributions.