Retirement Plan Sponsors Need To Care About Plan Design

By Ary Rosenbaum, Esq.

If you had your eyes set on a car and one model gave you 25 miles to the gallon and the other model gave you 45 with no difference in features or price, what would you choose? If you can find a coupon for items you were buying, wouldn't you? If you enjoying wasting money, this article isn't for you. This article is about retirement plan design and why finding the right TPA who can offer plan design services can that maximize savings for all of your employees and save money on taxes.

When it comes to the retirement plan business, very few plan sponsors understand the role of a TPA. People who are not experienced in the business feel that all that TPAs do is recordkeeping and/or performing simple mathematical discrimination tests. Very few plan sponsors and their financial advisors understand the value of a good TPA and their role in retirement plan design. Retirement plans are like suits, they are not one size fits all, they must be tailored to fit your size. A retirement plan must be designed specifically to meet your financial needs, demographics, and budget. A plan sponsor that's a law firm has different demographics and financial resources that can support a more generous employer contribution to maximize contributions to highly compensated employees than a fast food restaurant can. Buying a suit off the rack without getting tailored will leave you with something that doesn't fit, a retirement plan that doesn't fit your needs will lead to either leaving money on the table for the government to collect or requiring you to make contributions to your employees that really don't need to be made.

Many small businesses opt for a SEP (simplified employee pension plan) or a SIMPLE IRA. For many small businesses, this off the rack plan may be a great fit because there is no Form 5500 that needs to be filed or administrative expense because each participant essentially gets their own IRA (individual retirement account) as well as an equal share of employer contributions. Like my children's baby clothes, too many plan sponsors have outgrown these small plans. By agreeing to partake in these types of plans, plan sponsors must make a pro-rata employer contribution to their participants (which means they must make a contribution equal to the same percentage of pay). SIMPLE-IRA plans allow employees to defer, but with limits less than 401(k) plans ($12,500 vs. $18,000 in the 401(k) plan, as well as requiring a mandatory contribution to employees (much like a safe harbor contribution in the 401(k) plans that have them).

A perfect example of how a plan sponsor is no longer suited with these small plans is how one of my clients was able to save more and spend less in employer contribution by switching to a 401(k) plan. This company owned by a husband and wife had a SEP. Since their business was successful and they could both achieve the maximum annual benefit under a defined contribution of $53,000, they would have to make an employer contribution equal to 25% of pay to their other four employees. By switching them to a 401(k), this husband and wife (both over the age of 50) can defer $18,000 plus $6,000 in catch up. With enough employer contribution they can receive the $53,000 maximum benefit (which includes the $18,000 401(k) deferrals) plus the catch up contributions of $6,000 for a benefit of $59,000 each. For their participants under a 401(k) plan, they don't have to make a 25% employer contribution to plan participants. By using a new comparability/ cross tested plan design with a safe harbor feature, the plan sponsor only have to make a 5% contribution to participants (which includes the 3% safe harbor non-elective contribution). In English, my client was able to save more for retirement and pay less in employer contributions by switching

over to a 401(k) plan. Without an ERISA attorney or a good TPA looking over them, this Employer wouldn't have maximized contributions for their owners and would have spent more money in employer contributions that they needed to.

I have a lawyer client who also had a SEP who called me up a few years back and asked if there was a better plan design for him. Since he came into a $500,000 legal fee, he wanted to see if there was something better out there than the maximum $49,000 SEP contribution (which was the limit at the time). I asked him how old he was and how many employees he had. He hit the jackpot because he was 75 and he had no employees. Working with a TPA, I was able to design and implement a new defined benefit plan with an initial $230,000 contribution. A $230,000 tax deduction is a lot better than a $49,000 deduction, you think?

As an owner or highly compensated employee, you need to maximize the contributions you can make for retirement savings. The reason is simple: more money saved now is less tax you pay now. In addition, it is believed that to pay for the huge federal budget deficits over the last 30+ years and to bailout a Social Security program that will go bankrupt the year before I hit retirement age in 2038, marginal tax rates will go up. That is why it's important to consider ramping up retirement plan contributions, whether they are salary deferrals and employer contributions. The more you can afford to save now, the less in taxes you will have to pay now as rates are likely to go up.

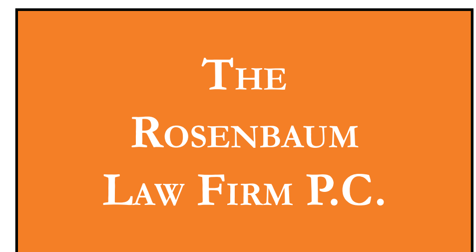
Plan sponsors and their financial advisors for the most part; don't know the value of a good TPA until they replace a bad TPA. A good TPA will administer and record keep the plan correctly, which will minimize potential fiduciary liability and plan sanction/disqualification. In addition, one of the most important functions of a good TPA is plan design. Plan design to me is an art, or a game like Chess. It's also like logic in 9th grade math. It's putting a complicated puzzle together and requires a thorough proposal. Too often, a payroll provider or a bundled provider or the not so good unbundled TPAs treat retirement plans as if they came off an assembly line. In my mind, there is no cookie cutter approach to retirement plans in their design and in their plan documents. As a plan sponsor, you have different employee populations, needs, and financial resources than other employers. So why get the same plan design as everyone else? Henry Ford's assembly line of everyone getting a black Model T was efficient, not so much for retirement plan designs.

An ERISA attorney (cough, cough) and/or a good TPA will sit down with you and review your needs for a new plan or to improve an existing plan. Based on the information collected, the ERISA attorney and/or the TPA will develop a retirement plan design that will fit your needs. That design may be a safe harbor plan, new comparability plan design, or the use of another plan like a defined benefit plan or a cash balance plan. Through almost 15 years in the business, I have seen retirement plans maximize contributions for their employees and/or correct administrative errors by using a good TPA.

I have had a client for 8 years now and a payroll company administered the plan when I first met them. The plan failed the deferral and matching discrimination tests by a wide margin. The owner of the company was getting a refund of $10,500 of her $12,000 deferral (that was the limit back then) at that time. A review of the test by the payroll provider TPA was that the plan could have corrected the failed discrimination test by adding a $7,500 qualified non-elective contribution. Even though it was there on the testing information, no one bothered to highlight that to the plan sponsor. Needless to say, the client paid the $7,500 corrective contribution, avoided all the refunds to the highly compensated employees, and implemented a safe harbor plan design the very next year. Since then, testing has never been an issue.

Sometimes retirement savings can be achieved by the addition of another retirement plan. It might be through a defined benefit plan, a cash balance plan, or in some instances, a non-qualified deferred compensation plan. A use of two plans together, called a combo plan can maximize contributions to the owners and highly compensated employees of an employer while maintaining a minimum benefit for the other rank and file employees. Depending on your financial strength, you might be surprised how much contributions you can add for your select employees through the combination with another plan or augmenting the formula of the current one.

Every few years, you need to have a checkup of your plan and your financial goals because things change and a tweak to your plan may save you money down the road. Not only can it save you money, but it's also a requirement of your fiduciary duty. The only way to do that is to seek a TPA and an ERISA attorney (cough, cough) that can handle a study and whether an upgrade in plan design is appropriate for you and your pocketbook.



Copyright, 2015. The Rosenbaum Law Firm P.C.
All rights reserved.
Attorney Advertising. Prior results do not guarantee similar outcome.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw