

Contribution Allocation Options

What You Need to Know

Understanding the options for allocating retirement plan contributions can help your clients meet their retirement plan and business objectives, while giving them the flexibility to not make contributions if other business needs come up. In addition to “pro-rata” allocations, which give the same percentage of compensation to all employees, alternative plan designs enable the plan sponsor to make larger contributions for some participants. We discuss these alternative plan designs below.



What are the benefits of alternative plan design features?

Maximum Savings and Flexibility

- Usually owners earn considerably more, and are often older, than their employees. These two factors allow them to benefit from an alternative plan design.
- Owners can deduct all employer-funded contributions up to 25% of eligible pay plus plan operating costs.
- The alternative plan designs allow a higher percentage of the employer-funded contributions to go towards the owners and selected participants.

FuturePlan will help you determine the plan design that best fits your client's needs.



What types of businesses are typically a good fit for alternative plan design features?

- Owner is exploring cost and tax-efficient methods for benefiting employees.
- Owner income is significantly higher than staff income.
- Owner is older than the majority of staff (best suited for new comparability formulas).



What is the timeline for updating the plan's allocation method?

- Plan sponsors considering a change to allocation methodology must do so before participants meet allocation conditions.
- A plan with a 1,000-hour requirement must amend their plan document before participants work 1,000 hours or wait until the following plan year to amend.
- If a plan requires employment on the last day of the plan year, plan sponsors have until the last day of each plan year to amend.



How do the alternative plan designs work?

New comparability

New comparability, also known as cross-testing, offers the most flexibility and can provide higher contributions for chosen participants. New comparability allows participants to be divided into groups based on objective standards such as job classifications. For example, a plan could have Group A consisting of owners, Group B consisting of highly compensated employees (HCEs) not in Group A, and Group C consisting of all other participants not in group A or B. The employer

can also put each participant in their own “group.” This gives the employer the most flexibility regarding the allocation a participant will receive. The employer then decides how much of a contribution to make to each group and the contribution is divided up between its members. Additional discrimination testing is required, and is usually passed if larger contributions are made to older participants. This allocation method is permissible because contributions are tested on a benefits basis, and younger employees require a smaller contribution to achieve the same benefit at retirement than someone who is closer to retirement.

Social Security integration

Integrating the plan contribution allocation with the Social Security taxable wage base, also referred to as permitted disparity, allows the employer to make larger contributions for participants earning more than the Social Security wage base, while providing those earning less than the integration level with a base pro-rata allocation. There is no additional testing required to make sure the allocations aren’t discriminatory.

The table below represents a professional practice with one highly compensated non-owner and owners who are 10 or more years older than half of the staff.

Name	Age (end of year 2023)	Plan Compensation	New Comparability & 401(k) with 3% Safe Harbor	SS Integration & 401(k) with Match	SS Integration & 401(k) with 3% Safe Harbor
			Max Owner(s)	Max Highest Earner	Max Highest Earner
Owner 1	53	345,000	76,500	76,500	76,500
Owner 2	49	185,000	69,000	43,210	43,210
		530,000	145,500	119,710	119,710
Staff 1	67	185,000	5,550	29,460	20,210
Staff 2	38	50,920	2,546	7,851	5,305
Staff 3	38	54,000	2,700	8,326	5,626
Staff 4	44	33,000	1,650	5,088	3,438
Staff 5	28	34,091	1,705	5,256	3,552
Staff 6	51	26,208	1,310	4,041	2,731
Staff 7	22	26,000	1,300	4,009	2,709
Staff 8	30	28,000	1,400	4,317	2,917
Employee Total		437,219	18,161	68,348	46,488
Totals		967,219	163,661	188,058	166,198
Percentage of Contributions to Owners			88.90%	63.66%	72.03%

Contact your FuturePlan consultant for more information about exploring contribution allocation options and alternative plan designs with your clients. We’re here to help.

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