

Contribution Allocation Options:

What You Need to Know

Discretionary nonelective, often called “profit sharing,” allocations provide a flexible means for business owners to increase their own retirement savings and tax deductions, while giving meaningful staff benefits at a reasonable cost. Cross-testing (new comparability) and Social Security integration (permitted disparity) features may be used in profitable years or set aside during lean years. Consider the important advantages of these retirement plan options for both you and your clients.



What are the benefits of alternative plan design features?

Maximize Savings and Flexibility

- Owners can achieve increased savings with reasonable staff costs.
- Owners can deduct all employer-funded contributions up to 25% of eligible pay plus plan operating costs.
- Plan sponsors can often allocate discretionary contributions in their favor and in favor of key personnel.
- FuturePlan designs plans with maximum flexibility so sponsors may select the allocation methodology that best fits their organization at the appropriate time.



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

- Owner is exploring cost and tax efficient methods for benefitting employees.
- Owner income is significantly higher than staff income.
- Cross-testing formulas work best for employer demographics with older owners and younger staff.



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 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 allocation methods work?

Cross-tested

A cross-tested feature divides employees into groups based on objective standards. A group can be as small as an individual employee, which provides an employer with the greatest amount of flexibility. The IRS allows a greater percentage of the profit-sharing contribution to be allocated to a certain group, typically owners, versus other groups. 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

Plan sponsors may integrate the Social Security taxable wage base (TWB) or a derivative of it into a plan's allocation formula. The feature favors high-earning, young owners by increasing contributions for participants earning more than the TWB with an additional allocation over the integration level, while providing those earning less than the integration level with a base pro rata allocation.

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 (EOY 2020) | Plan Compensation | Cross-tested & 401(k) w/ 3% Safe Harbor | SS Integration & 401(k) w/ Match | SS Integration & 401(k) w/ Nonelective |
|--------------------------------------|-------------------|----------------------|--|-------------------------------------|---|
| | | | Max Owners | Max Highest Earner | Max Highest Earner |
| Owner 1 | 53 | 285,000 | 63,500 | 63,500 | 63,500 |
| Owner 2 | 49 | 185,000 | 57,000 | 42,200 | 41,088 |
| | | 470,000 | 120,500 | 105,700 | 104,588 |
| Staff 1 | 67 | 185,000 | 5,550 | 22,700 | 21,588 |
| Staff 2 | 38 | 50,920 | 2,546 | 5,805 | 5,200 |
| Staff 3 | 38 | 54,000 | 2,700 | 6,157 | 5,514 |
| Staff 4 | 44 | 33,000 | 1,650 | 3,542 | 3,370 |
| Staff 5 | 28 | 34,091 | 1,705 | 3,660 | 3,481 |
| Staff 6 | 51 | 26,208 | 1,310 | 2,813 | 2,676 |
| Staff 7 | 22 | 26,000 | 1,300 | 2,791 | 2,655 |
| Staff 8 | 30 | 28,000 | 1,400 | 3,006 | 2,859 |
| Employee Total | | 437,219 | 18,161 | 50,474 | 47,344 |
| Totals | | 907,219 | 138,661 | 156,174 | 151,933 |
| Percentage of Contribution to Owners | | | 86.90% | 67.68% | 68.84% |



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Reach out to your FuturePlan TPA consultant for support and expert guidance. We're ready to help you answer client questions and make informed decisions, connecting you with ERISA experts and providing any other expert advice you may need.