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The Retirement Plan Authority

**RETIREMENT PLAN ENGINEERING**  
BUILDING A RETIREMENT PLAN FOR A PROFESSIONAL  
PRACTICE OR CLOSELY-HELD BUSINESS

**Tennessee Statewide  
Payroll Board**  
*August 9, 2019*



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# 2019 Qualified Plan Limits

Type of Contribution	2019 Limit
401(k), 403(b), 457 and TSP	\$19,000 - plus \$500
Catch-Up	\$6,000 - no change
SEP	\$56,000 - plus \$1,000
SIMPLE	\$13,000 - plus \$500
Defined Benefit/Cash Balance	\$225,000 - plus \$5,000
Compensation Limit	\$280,000 - plus \$5,000

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# Why Qualified Retirement Plans?

- Disciplined diversification away from business – no business liquidation at retirement
- Opportunity for tax savings and tax-sheltering to reduce current income
- Flexibility of Roth 401(k)
- More tax efficient asset allocation



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# Why Qualified Retirement Plans?

- Recruiting
- Retention
- Savings rate is not just for employees

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# Ground Work – Determining the Best Plan

## SEP, SIMPLE, or Qualified Plan?

- First question: what's the goal for the Plan?
- Second question: how much does the owner want to put away?
- Third question: what are the employer demographics?
- SEP Limit: 25% of compensation up to \$55,000
- SIMPLE Limit: \$12,500 plus \$3,000 catch-up plus match



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# Qualified Plan Starting Point: Safe Harbor 401(k)

- Avoids Average Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests as well as Top-Heavy test
- Safe harbor non-elective: 3% to everyone – not a match
- Basic match: 100% of deferrals up to the first 3% of pay; then 50% of the next 2%
- “Enhanced” match: 100% of deferrals up to the first 4% - 6% of pay
- Safe harbor employer contributions are fully-vested



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# Turning Up the Heat

## Cross-Tested Profit Sharing Plan:

- Typically combined with safe harbor 401(k) for maximum flexibility and efficiency
- Discretionary contributions
- Allocations based on formulas or by distinct classes
- Typically designed to provide greatest share of contribution to owner or professional
- Can be a part of the business bonus payment structure



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# Safe Harbor 401(k) Cross-Tested Profit Sharing Plan

Age	Compensation	Salary Deferral	Catch Up Deferral	Safe Harbor Non- Cross-tested Profit		Total 401(k) Profit Sharing	Employer Contribution Percentage	SEP Contribution	SEP Percentage
				Elective Contribution	Sharing Contribution				
50	\$ 275,000	\$ 18,500	\$ 6,000	\$ 8,250	\$ 28,250	\$ 61,000	13.27%	\$ 55,000	20.00%
46	20,000	18,500	-	-	-	18,500	0.00%	4,000	20.00%
<b>Total for Owner and Spouse</b>		<b>\$ 37,000</b>	<b>\$ 6,000</b>	<b>\$ 8,250</b>	<b>\$ 28,250</b>	<b>\$ 79,500</b>	<b>\$20,500 more to Owner and Spouse</b>	<b>\$ 59,000</b>	
35	\$ 33,275	\$ -	\$ -	\$ 998	\$ 474	\$ 1,472	4.42%	\$ 6,655	20.00%
42	32,000	-	-	960	456	1,416	4.42%	6,400	20.00%
<b>Total for Other Employees</b>		<b>\$ -</b>	<b>\$ -</b>	<b>\$ 1,958</b>	<b>\$ 930</b>	<b>\$ 2,888</b>		<b>\$ 13,055</b>	
<b>Grand Total</b>		<b>\$ 37,000</b>	<b>\$ 6,000</b>	<b>\$ 10,208</b>	<b>\$ 29,180</b>	<b>\$ 82,388</b>		<b>\$ 72,055</b>	
						<b>Efficiency</b>	<b>96%</b>		<b>82%</b>
						<b>Total cost for Employees:</b>	<b>\$ 2,888</b>	<b>\$10,167 Cost Savings</b>	<b>\$ 13,055</b>





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# What's Old is New Again: Defined Benefit Pension Plans

- Can Allow Contribution for Owner or Professional of Much Greater Than \$55,000 or \$61,000



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# Defined Benefit Plans

- Benefit paid at retirement is defined
- Monthly benefit payable for life of participant
- Benefits are not based on contributions to the Plan
- Contributions are based on benefits
- Funds are pooled - no individual accounts
- Employer takes the investment risk



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# How Much Can Be Contributed?

- Section 415 Limit for Defined Benefit Plans: \$220,000 annual benefit payable at Age 62 – *benefit, not contribution*
- Deductibility Limit: whatever it takes to fund the Plan
- Maximum benefit must accrue over at least 10 years



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# Combined Deductibility Limits: PBGC-covered Plans

- 25% for defined contribution plans (Employer Contributions) – doesn't count salary deferrals
- Whatever it takes for DB (minimum funding requirement)



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# Combined Deductibility Limits: Non-PBGC covered Plans

- 6% for DC *plus*
- Whatever it takes for DB/CB
- OR 31% Total for Employer contributions

*Professional practices with 25 or fewer employees or plans that cover only owners (and spouses)*



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# Cash Balance Plans:

- A defined benefit plan that looks like a defined contribution plan
- Each participant's benefit is an account balance rather than a "life annuity"
- Participant's "account" is credited with annual contributions plus interest credits



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# Cash Balance Plans

- Participants get statements much like in a defined contribution plan
- Cash balance plans still may be subject to PBGC coverage
- Lump sum benefits for owners are “stable”



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# Cash Balance Plans - DB Plan Characteristics

- Subject to Section 430 minimum funding requirements - actuary and Schedule SB required
- Employer makes all contributions
- Plan assets are in a pooled account - no participant direction
- Employer assumes all investment risk
- Maximum equivalent benefit at NRA is \$220,000





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# Cash Balance Plans - Advantages

- Participants have better understanding of benefit
- Tremendous flexibility in cash balance credits/contributions for professionals or owners
- Can be utilized to provide professionals with greater annual contributions than the \$55,000/\$61,000 annual defined contribution limit



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# 401(k) Profit Sharing and Cash Balance Pension Plan - Owner and Spouse

Date of Birth	Compensation	Plan Compensation	401(k) Profit Sharing Plan				Cash Balance Pension Plan		Grand Total	
			Salary Deferral	Catch-up Deferral	Profit Sharing Contribution	Total 401(k) Profit Sharing	Profit Sharing Contribution Percentage	Cash Balance Credit		Cash Balance Percentage
07/01/1964	\$ 700,000	\$ 280,000	\$ 19,000	\$ 6,000	\$ 16,000	\$ 41,000	6.00%	\$ 178,750	65.00%	\$ 219,750
07/01/1966	50,000	50,000	19,000	6,000	3,000	27,500	6.00%	2,125	4.25%	29,625
<b>Totals</b>	<b>\$ 750,000</b>	<b>\$ 325,000</b>	<b>\$ 37,000</b>	<b>\$ 12,000</b>	<b>\$ 19,500</b>	<b>\$ 68,500</b>		<b>\$ 180,875</b>		<b>\$ 249,375</b>



# 401(k) Profit Sharing and Cash Balance Pension Plan

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			Safe Harbor 401(k) Cross-Tested Profit Sharing Plan					Cash Balance Pension Plan			
Date of Birth	Date of Hire	Plan Compensation	Salary Deferral	Catch-up Deferral	Cross-Tested Profit Sharing Contribution	Total 401(k) Profit Sharing	Employer Contribution Percentage	Cash Balance Credit	Cash Balance Percentage	Grand Total	
07/01/1965	01/01/2012	\$ 280,000	\$ 19,000	\$ 6,000	\$ 36,000	\$ 61,000	13.27%	\$ 192,500	70.00%	\$ 253,500	
<b>Totals for Owner</b>		<b>\$ 280,000</b>	<b>\$ 19,000</b>	<b>\$ 6,000</b>	<b>\$ 36,000</b>	<b>\$ 61,000</b>		<b>\$ 192,500</b>		<b>\$ 253,500</b>	
07/01/1984	10/01/2016	\$ 30,000	\$ -	\$ -	\$ 2,400	\$ 2,400	8.00%	\$ 600	2.00%	\$ 3,000	
07/01/1967	04/01/2016	48,000	-	-	3,840	3,840	8.00%	960	2.00%	4,800	
07/01/1983	08/01/2012	40,000	-	-	3,200	3,200	8.00%	800	2.00%	4,000	
07/01/1981	10/01/2016	27,000	-	-	2,160	2,160	8.00%	540	2.00%	2,700	
<b>Total for Employees</b>		<b>\$ 145,000</b>	<b>\$ -</b>		<b>\$ 11,600</b>	<b>\$ 11,600</b>		<b>\$ 2,900</b>		<b>\$ 14,500</b>	
<b>Grand Total</b>		<b>\$ 420,000</b>	<b>\$ 18,500</b>		<b>\$ 48,100</b>	<b>\$ 72,600</b>		<b>\$ 195,400</b>	<b>\$ -</b>	<b>\$ 268,000</b>	
					<b>401(k) Plan Efficiency</b>	<b>92%</b>	<b>Cash Balance Plan Efficiency</b>	<b>99%</b>			
								<b>Combined Efficiency</b>	<b>97%</b>		



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# 401(k) Cross-Tested Profit Sharing and Cash Balance Pension Plan

Age	Compensation	Plan Compensation	Safe Harbor 401(k) Profit Sharing Plan						Cash Balance Pension Plan		Grand Total
			Salary Deferral	Catch Up Deferral	Safe Harbor Non-elective Contribution	Profit Sharing/Gateway Contribution	Employer Contribution Percentage	Total	Cash Balance Credit	Cash Balance Credit Percentage	
50	\$ 286,665	\$ 209,475	\$ 18,500	\$ 6,000	\$ 6,284	\$ 12,233	\$ 43,018	8.84%	\$ 70,000	33.42%	\$ 113,018
51	372,293	275,000	18,500	6,000	8,250	16,060	48,810	8.84%	70,000	25.45%	118,810
47	395,846	275,000	18,500	-	8,250	16,060	42,810	8.84%	70,000	25.45%	112,810
44	330,073	258,256	18,500	6,000	7,748	15,082	47,330	8.84%	70,000	27.10%	117,330
<b>Totals for Physicians</b>		<b>\$ 1,017,731</b>	<b>\$ 74,000</b>	<b>\$ 18,000</b>	<b>\$ 30,532</b>	<b>\$ 59,435</b>	<b>\$ 181,967</b>		<b>\$ 280,000</b>		<b>\$ 461,967</b>
35	\$ 30,795	\$ 30,795	\$ -	\$ -	\$ 924	\$ 1,848	\$ 2,772	9.00%	\$ 616	2.00%	\$ 3,387
36	34,130	34,130	-	-	1,024	2,048	3,072	9.00%	683	2.00%	3,754
30	84,479	84,479	-	-	2,534	5,069	7,603	9.00%	1,690	2.00%	9,293
37	76,890	76,890	-	-	2,307	4,613	6,920	9.00%	1,538	2.00%	8,458
41	41,820	41,820	-	-	1,255	2,509	3,764	9.00%	836	2.00%	4,600
42	26,535	26,535	-	-	796	1,592	2,388	9.00%	531	2.00%	2,919
<b>Totals for Other Employees</b>		<b>\$ 294,649</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 8,839</b>	<b>\$ 17,679</b>	<b>\$ 26,518</b>		<b>\$ 5,893</b>		<b>\$ 32,411</b>
<b>Grand Totals</b>		<b>\$ 1,312,380</b>	<b>\$ 74,000</b>	<b>\$ 18,000</b>	<b>\$ 39,371</b>	<b>\$ 77,114</b>	<b>\$ 208,486</b>		<b>\$ 285,893</b>		<b>\$ 494,379</b>
<b>Profit Sharing Plan Efficiency</b>								<b>87.28%</b>	<b>Cash Balance Plan Efficiency</b>		<b>98%</b>
<b>Combined Efficiency</b>										<b>93%</b>	



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# Tax Efficient Asset Allocation

- 401(k) salary deferrals: Roth or Pre-tax or both
- Earnings on outside taxable accounts: taxed as capital gains
- Roth earnings: tax-free



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# Tax Efficient Asset Allocation

- Defined benefit or cash balance plans – employer takes investment risk
- Older business owners probably need conservative or fixed income portfolio – often taxed as ordinary income
- Use DB/CB for part of fixed income portfolio



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# The Mother of All Roths

- This isn't feasible if there are non-highly compensated employees
- Qualified plans can allow after-tax contributions (after-tax contributions, taxable earnings) up to \$55,000
- Make first \$18,500/24,500 contribution Roth 401(k)  
(no income limit on Roth 401(k))



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# The Mother of All Roths

- Do an in-plan Roth conversion
- Any vested plan balance can be rolled over
- Amount rolled over less basis is includible in gross income
- Irreversible



# Questions and Discussion

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