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The Retirement Plan Authority

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

FINANCIAL PLANNING  
ASSOCIATION OF EAST  
TENNESSEE

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# Retirement and Tax Planning Challenges Facing Professionals and Business Owners

- Higher tax rates are likely
- 401(k) deferral limits are of limited value to high wage earners and business owners
- Savings rate is a far greater determinant of retirement income success than investment returns



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## Why Qualified Retirement Plans?

- Disciplined diversification away from business
- Opportunity for tax savings and tax-sheltering
- More tax efficient asset allocation

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# First Step for Maximizing Owner or Professional Benefits

SEP, SIMPLE, or Qualified Plan?

- First question: how much does the owner want to put away?
- Second question: what are the employer demographics?
- SEP Limit: 25% of compensation up to \$53,000
- SIMPLE Limit: \$12,500 plus \$3,000 catch-up plus match

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# Maximizing Professional or Owner Benefits

## Cross-Tested Profit Sharing Plan:

- Typically combined with safe harbor 401(k) for maximum flexibility
- Discretionary contributions
- Allocations based on formulas or by distinct classes
- Can be designed to provide greatest share of contribution to owner or professional

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# Maximizing Professional or Owner Benefits

Date of Birth	Compensation	Salary Deferral	Catch Up Deferral	Safe Harbor Non-Elective Contribution	Cross-Tested Profit Sharing Contribution	Total 401(k) Profit Sharing	Employer Contribution Percentage
07/01/1954	\$ 265,000	\$ 18,000	\$ 6,000	\$ 7,950	\$ 27,050	\$ 59,000	13.21%
<b>Total for Owner</b>	<b>\$ 265,000</b>	<b>\$ 18,000</b>	<b>\$ 6,000</b>	<b>\$ 7,950</b>	<b>\$ 27,050</b>	<b>\$ 59,000</b>	
01/29/1970	\$ 45,268	\$ -	\$ -	\$ 1,358	\$ 635	\$ 1,993	4.40%
04/30/1976	42,000	-	-	1,260	589	1,849	4.40%
04/30/1964	21,130	-	-	634	296	930	4.40%
<b>Total for Other Employees</b>	<b>\$ 108,398</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 3,252</b>	<b>\$ 1,521</b>	<b>\$ 4,773</b>	
<b>Grand Total</b>	<b>\$ 373,398</b>	<b>\$ 18,000</b>	<b>\$ 6,000</b>	<b>\$ 11,202</b>	<b>\$ 28,571</b>	<b>\$ 63,773</b>	
						<b>Efficiency</b>	<b>93%</b>

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# The Return of the Defined Benefit Plan

- Can Allow Contribution for Owner or Professional of Much Greater Than \$53,000 or \$59,000

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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: \$210,000 annual benefit payable at Age 62
- Sponsor can contribute as much as necessary to reach Section 415 limit
- Maximum benefit must accrue over at least 10 years
- Deductibility Limit: whatever it takes to fund the Plan

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## Combined Deductibility Limits: PBGC-covered Plans

- 25% for DC (Employer Contributions)
- Whatever it takes for DB (minimum funding requirement)

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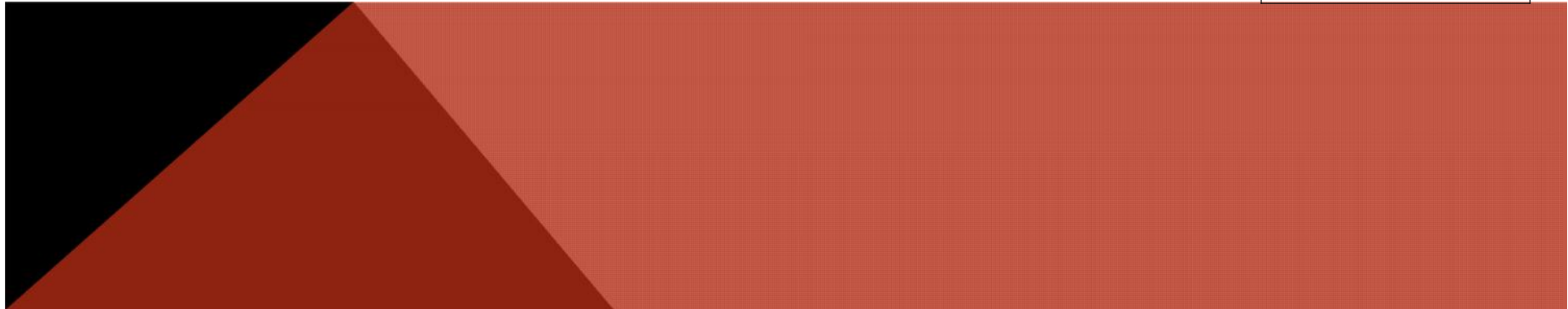


# Combined Deductibility Limits: Non-PBGC covered Plans

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

# DEFINED BENEFIT PLAN ILLUSTRATION

Date of Birth	Compensation	Safe Harbor 401(k) Cross-Tested Profit Sharing Plan						Defined Benefit Pension Plan		Grand Total	
		Salary Deferral	Catch Up Deferral	Safe Harbor Non-Elective Contribution	Cross-Tested Profit Sharing Contribution	Total 401(k) Profit Sharing	Employer Contribution Percentage	Contribution (Normal Cost)	Annual Benefit at NRA		
01/01/1951	\$ 260,000	\$ 17,500	\$ 5,500	\$ 7,800	\$ 26,700	\$ 57,500	13.27%	\$ 210,586	\$ 122,021	\$ 268,086	
<b>Total for Owner</b>	<b>\$ 260,000</b>	<b>\$ 17,500</b>	<b>\$ 5,500</b>	<b>\$ 7,800</b>	<b>\$ 26,700</b>	<b>\$ 57,500</b>		<b>\$ 210,586</b>		<b>\$ 268,086</b>	
01/01/1983	\$ 50,000	\$ -	\$ -	\$ 1,500	\$ 710	\$ 2,210	4.42%	\$ 11,387	\$ 50,000	\$ 13,597	
<b>Total for Employee</b>	<b>\$ 50,000</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 1,500</b>	<b>\$ 710</b>	<b>\$ 2,210</b>		<b>\$ 11,387</b>		<b>\$ 13,597</b>	
<b>Grand Total</b>	<b>\$ 310,000</b>	<b>\$ 17,500</b>	<b>\$ 5,500</b>	<b>\$ 9,300</b>	<b>\$ 27,410</b>	<b>\$ 59,710</b>		<b>\$ 221,973</b>		<b>\$ 281,683</b>	
							<b>Efficiency</b>	<b>96%</b>	<b>Defined Benefit Plan Efficiency</b>	<b>95%</b>	
									<b>Combined Efficiency</b>	<b>95%</b>	





## Cash Balance Plans:

- A defined benefit plan that looks like a defined contribution plan
- Each participant's benefit is a hypothetical 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, cont'd.

- Participants get statements much like in a defined contribution plan
- Cash balance plans are still subject to defined benefit plan requirements; e.g., Section 412 minimum funding and Section 415 annual additions
- Cash balance plans still may be subject to PBGC coverage



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# Cash Balance Plans - DB Plan Characteristics

- Subject to Section 412 minimum funding requirements - actuary and Schedule SB required
- Plan assets are in a pooled account - no participant direction
- Employer makes all contributions
- Employer assumes all investment risk
- Maximum equivalent benefit at NRA is \$205,000



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## Cash Balance Plans - Advantages

- Participants have better understanding of benefit
- Tremendous flexibility in cash balance credits/contributions for professionals
- Can be utilized to provide professionals with greater annual contributions than the \$53,000/\$59,000 annual defined contribution limit

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

		Safe Harbor 401(k) Cross-Tested Profit Sharing Plan						Cash Balance Pension Plan		
Date of Birth	Compensation	Salary Deferral	Catch Up Deferral	Safe Harbor Matching Contribution	Cross-Tested Profit Sharing Contribution	Total 401(k) Profit Sharing	Profit Sharing Contribution Percentage	Cash Balance Credit	Cash Balance Percentage	Grand Total
01/01/1952	\$ 265,000	\$ 18,000	\$ 6,000	\$ 7,950	\$ 27,050	\$ 59,000	13.21%	\$ 198,750	75.00%	\$ 257,750
01/01/1953	265,000	18,000	6,000	7,950	27,050	59,000	13.21%	185,500	70.00%	244,500
<b>Total for Owners 1 and 2</b>	<b>\$ 530,000</b>	<b>\$ 36,000</b>	<b>\$ 12,000</b>	<b>\$ 15,900</b>	<b>\$ 54,100</b>	<b>\$ 118,000</b>		<b>\$ 384,250</b>		<b>\$ 502,250</b>
01/01/1969	\$ 265,000	\$ 18,000	\$ -	\$ 7,950	\$ 27,050	\$ 53,000	13.21%	\$ -	0.00%	\$ 53,000
01/01/1986	100,000	-	-	3,000	-	3,000	3.00%	-	0.00%	3,000
<b>Total for Other Owners and HCEs</b>	<b>\$ 365,000</b>	<b>\$ 18,000</b>	<b>\$ -</b>	<b>\$ 10,950</b>	<b>\$ 27,050</b>	<b>\$ 56,000</b>		<b>\$ -</b>		<b>\$ 53,000</b>
01/01/1973	\$ 45,000	\$ -	\$ -	\$ 1,350	\$ 2,475	\$ 3,825	8.50%	\$ 1,125	2.50%	\$ 4,950
01/01/1978	38,000	-	-	1,140	2,090	3,230	8.50%	950	2.50%	4,180
<b>Total for Other Employees</b>	<b>\$ 83,000</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,490</b>	<b>\$ 4,565</b>	<b>\$ 7,055</b>		<b>\$ 2,075</b>		<b>\$ 9,130</b>
<b>Grand Total</b>	<b>\$ 613,000</b>	<b>\$ 54,000</b>	<b>\$ 12,000</b>	<b>\$ 29,340</b>	<b>\$ 85,715</b>	<b>\$ 181,055</b>		<b>\$ 386,325</b>		<b>\$ 564,380</b>
						<b>Efficiency</b>	<b>94%</b>	<b>Cash Balance Efficiency</b>	<b>99%</b>	<b>Combined Efficiency</b>
										<b>98%</b>

# Questions and Discussion

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