

# New Comparability Retirement Plan for the Business Owner

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The vast majority of business owners who already have or who are thinking of setting up a tax-qualified retirement plan, such as a profit-sharing plan, have one major goal in mind. They want to make significant tax-deductible contributions for their own benefit, which will reduce their current income tax bill and serve as a nest egg for their future. At the same time, they are not interested in maintaining a plan if the staff costs are too great. This goal of making significant contributions for owners and other key employees, while keeping staff costs under control, is not easily achieved under the Internal Revenue Code (“Code”). The Code generally requires that a tax-qualified retirement plan not discriminate in favor of highly compensated employees. This article discusses how the business owner’s goal can often be achieved, in whole or in part, through the creative use of a “new comparability” profit-sharing plan which satisfies the Code’s requirements.

Traditional profit-sharing plans and Simplified Employee Pension Plans (“SEPs”) require that a *level* percentage of compensation be contributed on behalf of all plan participants. As a result, in a traditional arrangement, if the business owners want to increase contributions on their own behalf, they need to also increase the contributions for their staff. This will often be costly and unsatisfactory, particularly if the business has a large staff.

In a new comparability plan, actuaries use certain IRS-blessed “cross-testing” rules, and demonstrate compliance with the non-discrimination requirements by converting the contributions that are made under the plan to their equivalent benefits under a defined benefit pension plan. All of this is done “behind the scenes” so that the plan is easily understandable by the owners and their employees. While these tests are sensitive to demographics and do not always yield favorable results, in many situations — particularly, if the group that the owner wants to favor is predominantly older than the rest of the employees — they allow higher contribution rates for the business owners and other key employees than for the rank and file staff. In addition, new comparability often provides a plan with flexibility and allows different groups of owners and highly compensated employees to have different contribution rates.

To demonstrate this, assume that there are two business owners and four employees for a total of six plan participants. One of the employees is the wife of one of the owners. The compensation and contributions under a new comparability plan are set forth below:

## New Comparability - Case Study

| Employee       | Compensation | Contribution | % of Compensation | % of Total   |
|----------------|--------------|--------------|-------------------|--------------|
| Owner [Age 46] | \$230,000    | \$46,000     | 20%               |              |
| Owner [Age 55] | \$230,000    | \$46,000     | 20%               | \$92,960 94% |
| Wife [Age 53]  | \$ 19,200    | \$ 960       | 5%                |              |
| Staff [Age 40] | \$ 48,346    | \$ 2,417     | 5%                |              |
| Staff [Age 32] | \$ 38,500    | \$ 1,925     | 5%                | \$6,367 6%   |
| Staff [Age 26] | \$ 40,500    | \$ 2,025     | 5%                |              |

Although one owner is 46 years old (which some might consider to be “young”), he is still older than each of his employees by six years or more. That “age spread” is one of the key components to successfully maximizing the contributions for the owners while minimizing staff contributions.

In our example, a new comparability formula has been devised that gives the owners the maximum allowable contribution under the Code. For 2008, that means a contribution per owner of \$46,000. Under the facts in the example, the contribution rate for the owners is 20% of compensation. Applying actuarial cross-testing, contributions for the other employees are set at 5% of compensation. This results in the owners and the wife receiving 94% of the total contribution that is made to the plan and the staff employees receiving only 6% of the total contribution.

Other defined contribution plan strategies could not possibly provide the owners with the contributions they seek and, at the same time, keep the cost at a minimum for the other employees. In a traditional profit-sharing or SEP, in order for the owners to receive \$46,000, each staff member would have to receive a contribution of 20% of compensation. The staff cost for a traditional plan utilizing the demographics in the case study would be approximately \$25,500 versus approximately \$6,300 in the new comparability plan. In this example, the new comparability plan design results in a staff cost savings of over \$19,000 per year!

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### *New Comparability Retirement Plan*

As the above example demonstrates, an owner of a successful business who does not yet have a qualified plan should consider establishing one, utilizing a new comparability design. In addition, owners of a business who already have a plan should review their existing retirement plan arrangement to see if they are really maximizing their own benefits. Often, a plan that might have made sense when it was installed is later found to no longer optimize benefits under changed circumstances. If your clients do not yet have a profit-sharing plan, or if they have a profit-sharing plan or SEP that uses a formula other than new comparability and your clients would like to see what new comparability can do for them, kindly contact Andrew E. Roth, Esq. at (914) 948-1556 or at [aroth@dmlawyers.com](mailto:aroth@dmlawyers.com).

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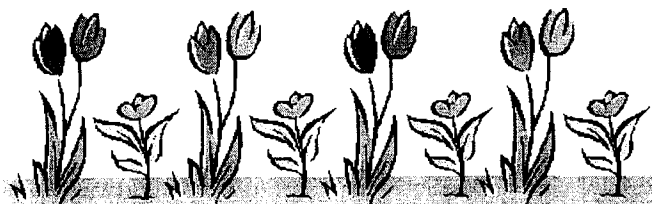
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To prepare for the opening of the Center, the New York State Unified Court System hosted two training sessions at Pace University's New York Judicial Institute in March. Over 200 professionals from three disciplines (lawyers, financial planners and mental health professionals) attended the 3 day Mediation Training and the two-day Interdisciplinary Collaborative Divorce Training. Each session paired a renowned national trainer with local experts: Jack Himmelstein and Katherine E. Miller, Esq. for the Mediation Training and Pauline Tesler, M.A, J.D with Maria Alba-Fisch, Ph.D and Dian Drake, CFP®, CDFA for the Interdisciplinary sessions.

For more information about the new center go to <http://www.nycourts.gov/ip/collablaw>.

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