Designing Your Retirement Plan Around Today's Challenges

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  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 5,000 employees
- Offices coast to coast
- Providing employee benefit plan audit, tax compliance, and consulting servi

- CLA is ***a leading provider*** of employee benefit plan audits in the country*

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Speaker Introductions

Denise Falbo

- Director – Director-TPA Operations
- More than 15 years of experience in the design and administration
  of qualified retirement plans

John Stiglich

- Managing Principal of Retirement Services, CliftonLarsonAllen Wealth Advisors, LLC
- Over 38 years of experience in working with qualified retirement plans.
- Assists wealth advisors across the firm in selling and servicing qualified retirement plans.

Learning Objectives

At the end of this session, you will be able to:

- Recognize the warning signs for plan designs that do not meet their intended retirement benefits
- Examine how a cross-tested retirement plan design can enhance your benefits and tax savings
- Identify if a cash balance plan would be a strategic addition to your current 401(k) plan, and the allocations this combo plan design can offer
- Understand the importance of complying with the safe harbor deadline and regulations

2018 Plan Limits

- 401(k)/403(b) Salary deferrals - $18,500
- Additional (catch-up) deferrals age 50 or older - $6,000
- Total 2018 salary deferral limit - $24,500
- Contributions per individual - $55,000 (additional $6,000 if age 50 or older)
- Maximum considered compensation: $275,000
- Employer deduction limit = 25% of total eligible compensation (excludes salary deferrals)

Definitions Are Different

- Highly Compensated Employee (HCE):
  - Earned MORE THAN $120,000 in 12 months immediately preceding the plan year being tested
  - More than 5% owner of the company for plan year (being tested) or the immediately preceding plan year
  - Certain relatives of the more than 5% owner

Key Employee:

- More than 5% owner
- Owns more than 1% and compensation is greater than $150,000
- Officer earning more than $175,000

DESIGN IS A PLAN FOR ANALYZING ELEMENTS IN SUCH A WAY AS BEST TO ACCOMPLISH A PARTICULAR PURPOSE.

Charles Eames

WHAT IS YOUR PURPOSE IN MAINTAINING YOUR QUALIFIED RETIREMENT PLAN?

Possible/Common Objectives:

- Minimize taxes
- Reward, recruit and retain employees
- Diversify wealth
- Asset protection
- Competitiveness in industry/geography
- Retirement savings – only 50% of U.S. workers are covered by an employer plan

YOUR PLAN DESIGN MUST ALSO MEET IRS AND DOL REGULATIONS

Why is Plan Design Important?

- IRS Perspective
  - In exchange for tax advantages, certain requirements must be met:
    - ◊ Non-discrimination
    - ◊ Minimum benefits to non-key employees in certain situations
    - ◊ Plans may not exclusively benefit owners and highly paid employees
    - ◊ Several annual tests must be performed to ensure plan compliance

Why is Plan Design Important?

- DOL Perspective
  - Serves to protect the rights and assets of plan participants
  - Minimum standards as to eligibility, who is covered, vesting of benefits
  - Participant notice requirements
  - Timely deposit of participant contributions

Warning Signs Your Plan Design May Not Be Working:

- Annual failure of non-discrimination tests (ADP/ACP) - Do owners or highly paid employees receive refunds?
- Do employees fail to contribute?
- Is the plan no longer affordable because the plan is top heavy or the plan sponsor has required contributions?
- Are owners and key employees precluded from contributing due to the plan's top heavy status?
- If tax reduction is desired, are contributions at the business' desired level to meet this goal?
- High earners want to contribute more toward their retirement.

When is a Plan Top Heavy?

When the account balances of the key employees exceed 60% of total account balance of the plan.

What are the Implications?

When any of the key employees contribute to the plan, minimum contributions must be made for the eligible non-key employees. Minimum contributions – generally 3% of full year compensation.

Company Changes That May Require Updates to Plan Design:

- Ownership changes/retirement of owner
- Hiring of family members of owners
- Acquisitions and mergers
- Related employer situations
- Change in employee demographics or company growth or downsizing
- Changes to compensation structure

Plan Design Not Working:

- Buffy Buffett owns Buffett Marketing Firm
- 2018 ADP non-discrimination test is performed.
- The test fails.
- The plan is not top heavy, yet.
- Buffy must receive a refund of $7,000 of her salary deferrals, plus earnings.
- Buffy contributed $18,500 of pre-tax salary deferrals - the 2018 maximum.

BUFFET MARKETING FIRM PLAN DESIGN SUMMARY
FOR THE PLAN YEAR 1/1/2018 THROUGH 12/31/2018

Census Data			Deferrals		Addition of 3% Safe Harbor	Addition of Safe Harbor Match *
Name	Earnings	Att Age	$$	%	$$	$$
HIGHLY COMPENSATED EMPLOYEES:						
Buffy Buffett	$250,000	49	$18,500	7.40%	$7,500	$10,000
Average Deferral Rate:				7.40%		
NON-HIGHLY COMPENSATED EMPLOYEES:						
Employee B	$22,485	46	$0	0.00%	$675	$0
Employee C	$30,000	27	$1,500	5.00%	$900	$1,200
Employee D	$21,000	31	$840	4.00%	$630	$840
Employee E	$30,536	47	$1,527	5.00%	$916	$1,221
Employee F	$24,014	35	$0	0.00%	$720	$0
Employee G	$22,747	25	$1,137	5.00%	$682	$910
Employee H	$28,000	32	$0	0.00%	$840	$0
Average Deferral Rate:				2.71%		
	$428,782		$23,504		$12,863	$14,171
			TEST FAILS		PASS	PASS

Buffy's share of safe harbor:

58.30%	70.57%

*** Assumes dollar for dollar match up to 4% of comp. deferred**

Safe Harbor Advantages:

- Without safe harbor, refund to Buffy of $7,000+. Buffy loses the tax deferral of her contributions, and loses the tax-deferred earnings on the $7,000+
- Addition of 3% safe harbor costs $12,863. $7,500 (58%) of this goes to Buffy. Buffy keeps her deferrals in the plan.
- Or, addition of safe harbor match costs $14,171. $10,000 (70.6%) of that match contribution goes to Buffy. Buffy keeps her deferrals in the plan.
- If the plan WERE top heavy and the safe harbor match is used, no 3% top heavy minimum contribution has to be made for the employees who are not contributing.

Adding Safe Harbor Provisions

- Existing plans: Amend plan. Adopt no later than 30 days prior to start of the next plan year. (Calendar year plans by December 1st).
- New start-up plans: Adopt no later than October 1st of year of adoption. (Safe harbor provisions must be in effect for at least 3 months, for new plans.)
- Annual notice requirement – distribute 30 days in advance of upcoming plan year.
- May remove safe harbor provisions during the plan year – special rules apply

How Does Safe Harbor Plan Design Help?

- Safe harbor plans get a pass on non-discrimination testing. This allows the highly compensated employees to contribute much more in proportion to the non-highly compensated employees.

- May also be used in 403(b) plans to help pass non-discrimination testing of matching contributions.

- Safe harbor plans generally receive an exemption from the top heavy minimum contribution requirements.

Other Ways to Solve the 'ADP Refund' Issue:

- Have the business owners stop contributing (NOT A RESOLUTION!)
- Reduce the number of highly compensated employees by electing the 'top paid election'.
- Cap the deferral rate for each highly compensated employee.

Low Deferrals in 401(k) Plans – Consider Automatic Enrollment

- All employees meeting the plan eligibility criteria are automatically enrolled in the plan at a pre-determined deferral rate, usually 3% to 6%
- Employees may change the deferral rate or opt-out of participation in the plan.
- Provision can be added for new employees only or all existing employees.
- Automatic enrollment is normally combined with an auto-escalate option which increases the deferral rate 1% per year up to 10%
- This design uses "participant inertia" for the benefit of the employee to help them reach their retirement goal.

WHAT IS CROSS TESTING AND HOW CAN AN EMPLOYER BENEFIT?

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TRADITIONAL PROFIT SHARING FORMULAS GIVE THE SAME CONTRIBUTION, AS A PERCENTAGE OF PAY, TO EACH ELIGIBLE EMPLOYEE.

Introduction to Cross Testing (Also Known as New Comparability)

- Allows contributions to owners and highly paid employees that are higher in proportion to those to non-owners and non-highly paid employees.
- Maximizes tax savings for the business and retirement savings for the business owner and HCE’s.
- Allows employer flexibility to pick and choose amounts given to employees (same contribution rate to each employee is not required)
- Requires its own non-discrimination testing

More About Cross Testing

- Each participant's current year contribution is projected, with interest, to a lump sum at normal retirement age
- The lump sum is then converted into a straight life annuity and divided by the participant's compensation (resulting in a factor).
- Factors of HCE's and owners are compared with the factors of non-owners/non-highly compensated employees (NHCE's). If the NHCE's' benefits are at least 70% of the HCE's' benefits, the allocation passes testing.

DR. LAWRENCE MEDICAL PRACTICE
401(K) NEW COMPARABILITY PROFIT SHARING PLAN WITH SAFE HARBOR FEATURE
FOR THE PLAN YEAR 1/1/2018 THROUGH 12/31/2018

							Deferrals		3% Safe Harbor	Profit Sharing		Over Age 50 Catch-up	Total Contribution			
P	O	H	C	Name	Earnings	Age	$$	%	$$	$$	%	$$	Amount	% of Pay	Employer Cost $$	% of Total
*	*	*	A	Dr. Lawrence	$275,000	53	$18,500	6.73%	$8,250	$28,250	10.27%	$6,000	$61,000	22.18%	$61,000	88.53%
			B	Employee B	$22,485	46	$1,124	5.00%	$675	$319	1.42%	$0	$2,118	9.42%	$994	1.44%
			B	Employee C	$30,000	27	$1,500	5.00%	$900	$426	1.42%	$0	$2,826	9.42%	$1,326	1.92%
			B	Employee D	$21,000	31	$1,050	5.00%	$630	$298	1.42%	$0	$1,978	9.42%	$928	1.35%
			B	Employee E	$30,536	47	$1,527	5.00%	$916	$434	1.42%	$0	$2,877	9.42%	$1,350	1.96%
			B	Employee F	$24,014	35	$1,201	5.00%	$720	$341	1.42%	$0	$2,262	9.42%	$1,061	1.54%
			B	Employee G	$22,747	25	$1,137	5.00%	$682	$323	1.42%	$0	$2,142	9.42%	$1,005	1.46%
			B	Employee H	$28,000	32	$1,400	5.00%	$840	$398	1.42%	$0	$2,638	9.42%	$1,238	1.80%
				TOTALS ->	$453,782		$27,439		$13,613	$30,789		$6,000	$77,841		$68,902	100.00%

Dr. Lawrence receives profit sharing and safe harbor totaling 13.27% of compensation. Other employees each receive 1/3 of Dr. Lawrence's contribution rate, or profit sharing & safe harbor totaling 4.42% of their compensation.

How is Cross Tested Plan Design Beneficial?

- 88.5% of the employer contribution is earmarked for Dr. Lawrence.
- Employees are still receiving generous contributions from the employer.
- Contribution is discretionary each year. Profit sharing does not have to be funded, or employer may use a pro rata formula.
- Contributions to other HCE's can be less than those to the owner, or even zero.

Ideal Situation For Cross Testing:

- Owners and highly paid employees are older than non-owners and non-highly paid employees
- There are no younger owners or key employees whom the plan sponsor wants to provide an equal benefit to
- Spouses of owners may need to receive lesser benefits
- Prevailing Wage plans
- Can be used by 403(b) Plans as well
- Can be used in conjunction with safe harbor design

How Do I Incorporate Cross Testing Into My Plan Design?

- Amend plan before last day of plan year in which cross testing becomes effective
- No obligation to use each year – may use pro rata contribution instead (everybody receives a profit sharing contribution that is the same percentage of pay)
- Balances of employees with short tenure may be unvested at termination – these funds will become forfeited and can be used for other reasons.

Prevailing Wage Plans

- Cross testing can be used in prevailing wage plans.
- Fringe benefit portion is contributed to the plan.
- Saves payroll taxes paid by employer.
- Certain vesting and distribution rules apply.

Cash Balance and Defined Benefit Plans

- Plans are established by the business entity
- Plans designed to offer high contributions to owners
- **Plan contribution is mandatory in good and bad years.**
- Plan can be combined with a 401(k) plan
- **Plan must be in existence for 5 years, 10 is preferred**
- Contributions are funded into a plan trust
- Benefits are actuarially calculated
- Plan must be established by December 31st
- Higher initial set-up, annual administration and termination fees apply

Cash Balance Plans

- Maximum contributions depend on age and compensation. Estimated maximums assuming compensation of $220,000 or more:
  - Age 40 $90,000
  - Age 50 $155,000
  - Age 60 $260,000
- Account is comprised of a Cash Credit (Company Contribution) and an Interest Credit based upon a pre-determined interest rate/index.

Cash Balance Plans (continued)

- Account balance can be subject to vesting schedule – maximum is 3 year cliff vesting
- If appropriate funding level is maintained, distributions from the plan are in the form of a lump sum
- Cash Balance Plans can be integrated with a 401(k) option for employees and employee/owners

Cash Balance Plan

- Example – Case Study #1
  - 2018 Cash Balance Plan to maximize retirement plan contributions each year
    - ◊ Objective to increase tax deductible contribution for client and spouse
      - Enhance retirement savings growth
      - Obtain income tax benefit for funding at high tax rates
    - ◊ Trade Offs
      - Cost to fund employee benefit versus client & spouse
        - Net of Tax benefit
      - Plan administration costs

Cash Balance Plan (continued)

- Cash Balance Plan
  - Client
  - Client spouse
  - Contributions
    - ◊ Client - $131,200/year
    - ◊ Spouse -$131,200/year
    - ◊ Employees - $7,423/year
  - Schedule of estimated contributions

401(k)/Cash Balance Combo Plan

Highly profitable small business with both spouses Employed in the business.

Employee	Age	Compensation	401 (K) Deferral	PS Contribution	Cash Balance	Total Allocation	Allocation as a Percentage of Total
Owner 1	62	$134,000	$24,500	$6,700	$100,000	$131,200	48.34%
Owner 2	57	134,000	24,500	6,700	100,000	131,200	48.34%
EE #1	48	20,140	403	1,129	500	2,032	.76%
EE #2	45	18,550	371	1,225	500	2,096	.78%
EE #3	42	10,160	203	671	500	1,374	.51%
EE # 4	46	18,297	366	1,208	500	2,074	.76%
EE #5	42	10,456	209	690	500	1,399	.51%
Total		**$345,603**	**$50,552**	**$18,323**	**$202,500**	**$271,375**	**100%**

Most Plan Designs Are Not Permanent!

REVIEW PLAN DESIGN PERIODICALLY – IDEALLY ON ANNUAL BASIS

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Questions?

Denise Falbo, ERPA, QPA, QKA, CRPS®
Director – TPA Operations
denise.falbo@CLAconnect.com
815-272-9822

John Stiglich, CPA, CFP®, PFS, AIF, CPFA
Managing Principal, Retirement Plan Services
john.stiglich@CLAconnect.com
815-272-9812

linkedin.com/company/cliftonlarsonallen
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