Next Level Profit Sharing Plans

A retirement plan cannot discriminate in favor of “highly compensated employees” in either contributions or benefits. This, however, does not mean that everybody has to receive the same contribution. Far from it. When designing a “Next Level” profit sharing plan, many pension plan providers offer three tools that can be used to craft the plan that best meets the company’s goals and budget.

These include the following:

1. “Integration” with Social Security
2. Age-Weighting the Contribution
3. New Comparability Classification Plans

To best understand the impact of each of these tools, let’s consider the following example:

Employee Name	Age	Current Salary	Traditional	Integrated	Age-Weighted	New-Comparability
Owner (key)	**55**	**$225,000**	**$45,000**	**$45,000**	**$45,000**	**$45,000**
% of Pay			**20%**	**20%**	**20%**	**20%**
Key Employee	45	$100,000	$20,000	$16,912	$8,846	$10,000
% of Pay			20%	16.9%	8.8%	10%
Employee 1	30	$40,000	$8,000	$6,708	$1,200	$2,000
% of Pay			20%	16.80%	3.0%	5%
Employee 2	35	$35,000	$7,000	$5,870	$1,369	$1,750
% of Pay			20%	16.80%	3.9%	5%
Employee 3	30	$25,000	5000	$4,192	$750	$1,250
% of Pay			20%	16.80%	3.0%	5%
Total			**$85,000**	**$78,682**	**$57,165**	**$60,000**
% to Owner			**53%**	**57%**	**79%**	**75%**

Integrated Profit Sharing Plans

All employers already sponsor at least one retirement plan jointly funded by employers and employees. It’s called the *Old Age & Survivor Benefit* of Social Security. Government rules let you take this into account by allowing you to “integrate” your qualified retirement plan with your Social Security contributions. Although the rules are flexible and somewhat complex, this concept helps employers skew additional benefits to the highly compensated employees while lowering them somewhat for the lower-paid workers.

Under an Integrated Profit Sharing Plan, compensation is broken out into two parts—the amount above the integration level (excess compensation) and the amount below the integration level (base compensation). Usually the integration level is the Social Security Taxable Wage Base in effect for the applicable year. The employer is permitted to "offset" their contribution to Social Security by applying a lower contribution percentage to the base compensation (i.e., the base percentage) and a higher contribution percentage to the excess compensation (i.e., the excess percentage).

A Profit Sharing Plan Integrated with Social Security works best in situations when the company wants to make greater contributions to highly compensated employees who are the **same age or younger than the other employees**.

Age Weighting

The final regulations governing nondiscrimination (found in IRC 401(a)(4)) introduced an old pension plan concept to profit sharing plans. Recall that the contribution cannot discriminate in either contributions *or* benefits. Therefore, giving everybody 20% of pay is clearly nondiscriminatory. However, giving each the same theoretical retirement benefit is also nondiscriminatory, as with a defined benefit plan.

Why is Age Weighting a profit sharing plan helpful? The reasoning is simple: with fewer years until retirement, **older participants require larger contributions** than younger participants to get to the same benefit level.

A review of the design chart shows that this plan is perhaps the most favorable to the owner. However, in operation, it is a little cumbersome. Older employees get higher contributions, period. Employees in the same job, getting similar wages, will get very different contributions unless they share the same age. Because of these reasons, this plan is less popular than the next option.

New Comparability

Perhaps the most exciting development in pension plans, this "Next Level" design offers a method to allocate significantly greater contributions to **specific classes** of employees. It **combines** both the integration and age-weighted rules, but uses weighted averages to determine the contribution. This plan is ideal for principals who:

-Are older and **earn more than most of their employees**;

-Want the biggest possible share of the plan contribution allocated to their own accounts; and,

-Desire the contribution flexibility of a profit sharing plan.

This type of plan is known by many names: "super-integrated," classification plan, group allocated plan, and, more commonly, "new comparability." Because it was finalized in the Code in 1993, it is really no longer new; so I prefer to call it super- comparability since it is among the most flexible of plans and can target, with precision, extra benefits to select classes of employees.

New Comparability is highly customizable and can be matched to a business quite easily. For example, groups can be created for different profit centers, subsidiaries, sister companies or, most commonly, by job class—in short, any clearly identifiable group. Some common examples include:

1. Owners	1. Sr. Partners	1. Executives
2. Non-Owners	2. Jr. Partners	2. Managers
	3. All Other Employees	3. Employees of Subsidiary A
		4. Employees of Subsidiary B

Some sponsors get quite creative to create clearly identifiable classes that best match their business organization. Interestingly, creating different classes does not mean you have to give different contributions in any given year. In some years, you can give each class zero or perhaps 25% of pay to everyone. It's your call, as long as the contribution satisfies testing each year.

The basic rule of thumb is that the contribution you give to the bottom group(s) will determine how much you can give to the others. If the preferred groups are, on average, older than the bottom groups, you should be able to leverage modest contributions to the rank and file employees into substantial contributions to the other groups.

