

## New Comparability Plans

Employers often want to maximize the benefits for their senior executives under their qualified retirement plans. In 1992, our firm pioneered a plan design specifically intended to meet this objective. We called this plan design “New Comparability”.

If you have a profit sharing, 401(k) or money purchase pension plan, then our New Comparability methodology may be of immediate interest to you. The following example is based on our analysis of a plan covering two owners and their four employees. However, this could just as well be a plan covering 50 employees or 5,000 employees. In the example, the company have previously been contributing 15% of pay for each plan participant in their traditional profit sharing plan. The owners want to increase the portion of the total contribution that is allocated to their own accounts.

The table below shows how a 15% of pay contribution is allocated under a traditional profit sharing plan and under two New Comparability plans. Notice how the New Comparability allocations (shown on the right side of the table) compare with the traditional formula.

	<u>Age</u>	<u>Pay</u>	<u>Traditional Plan</u>	<u>New Comparability</u>	
				<u>Minimize Contributions to Employees</u>	<u>Maximize Contribution for Owners</u>
Owner A	40	\$200,000	\$30,000	\$38,250	\$40,000
Owner B	52	<u>200,000</u>	<u>30,000</u>	<u>38,250</u>	<u>40,000</u>
<b>Sub Total</b>		<b>\$400,000</b>	<b>\$60,000</b>	<b>\$76,500</b>	<b>\$80,000</b>
Employee 1	29	\$25,000	\$3,750	\$1,250	\$1,250
Employee 2	32	35,000	5,250	1,750	1,750
Employee 3	34	45,000	6,750	2,250	2,250
Employee 4	47	<u>60,000</u>	<u>9,000</u>	<u>3,000</u>	<u>3,000</u>
<b>Sub Total</b>		<b>\$165,000</b>	<b>\$24,750</b>	<b>\$8,250</b>	<b>\$8,250</b>
<b>Total</b>		<b>\$565,000</b>	<b>\$84,750</b>	<b>\$84,750</b>	<b>\$88,250</b>
<b>% to Owners</b>			<b>70.8%</b>	<b>90.3%</b>	<b>90.7%</b>

Under the traditional allocation method with an employer contribution of \$84,750, each of the owners is allocated \$30,000 with the remaining \$24,750 being allocated to the other employees. Under the first New Comparability

method, the same \$84,750 contribution is allocated so that each of the owners receives \$38,250 and the remaining \$8,250 is allocated to the other employees. The owners each receive 19.12% of pay while the employees receive 5.00% of pay. Under the second New Comparability Allocation, the owners' contribution is increased from \$38,250 to \$40,000 with no change in the allocation to the other employees.

Since qualified plans cannot discriminate in favor of highly compensated employees, how is this possible? We can do this because IRS regulations allow us to test for discrimination based either on the contributions that the employer makes or on the retirement benefits these contributions can provide. For most companies, testing the benefits rather than the contributions produces a more favorable result for key executives. This is because the amount of benefit that can be provided by any contribution level depends on the participant's age. Younger participants receive a larger benefit than older participants because the contribution has more years to grow with investment income. This is similar to an annuity contract, where a given premium will provide a larger benefit for a younger person. Therefore, if the participants with the larger contribution rates (the two owners in our example) are older than a sufficient number of the other participants, the plan can be shown to be nondiscriminatory.

We have found that this new allocation method, by providing a greater potential to direct contributions towards higher paid employees, can have many applications to all types of employers and all sizes of plans. For example:

- ✓ It may enable smaller employers to establish plans while keeping the cost for employees at an affordable level.
- ✓ For larger employers, it may permit controlling the cost for employees without diminishing executives' benefits.
- ✓ If a company provides unfunded, nonqualified deferred compensation benefits for executives and has a defined contribution plan (or even a cash balance pension plan), New Comparability may provide an alternative that permits funding all or a part of those executive benefits. Similarly, it may be used to help fund supplemental executive retirement plans.
- ✓ It may permit a plan to increase contributions for a select group of employees, for example, employees at a particular division or employees with a particular, valuable skill that the company wants to attract or retain.
- ✓ It can be used at professional firms to permit a larger contribution for partners or shareholders without increasing the cost for other employees.

The New Comparability method may not achieve dramatic results in all cases. Its success depends upon the demographics of the plan's employee population.

New Comparability is based on regulations under Section 401(a)(4) of the Internal Revenue Code. These regulations set forth the rules for determining whether or not a retirement plan discriminates in favor of highly compensated employees. Though these rules are considered very complex and restrictive, they contain objective tests to determine whether or not a plan discriminates.

If you believe that the New Comparability method might be of value to your company, our consultants would be delighted to explain it in more detail. If you like the New Comparability concept but would like to contribute more than \$40,000 for your key employees, please ask about our Cash Balance Pension Plans.

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