

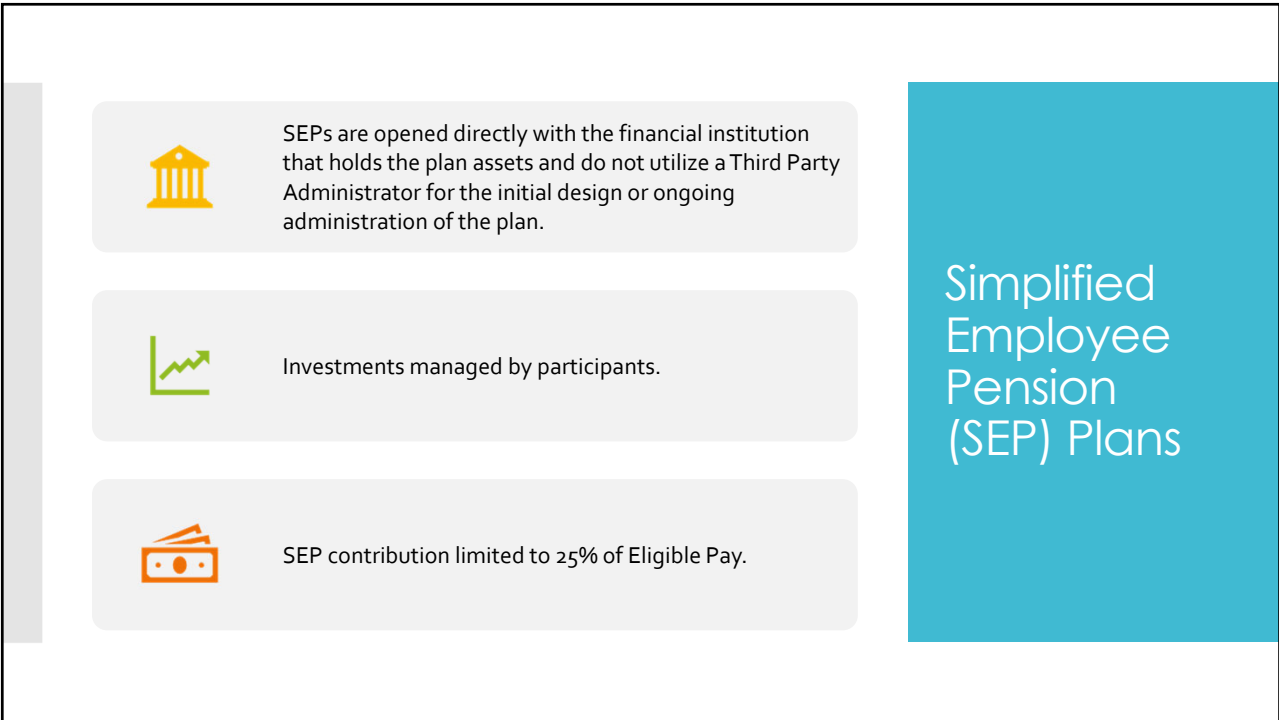


Retirement  
Plans


Options, Comparisons  
and Illustrations





**E. DEMMLER  
& ASSOCIATES**  
WEALTH MANAGEMENT



The infographic is contained within a black rectangular border. On the left side, there is a vertical grey bar. The main content area is divided into three horizontal grey rounded rectangles, each containing an icon and a text block. To the right of these is a large teal rectangle with white text. The icons are: a yellow classical building, a green line graph with an upward arrow, and an orange wallet with cash. The text in the teal box reads 'Simplified Employee Pension (SEP) Plans'.

 SEPs are opened directly with the financial institution that holds the plan assets and do not utilize a Third Party Administrator for the initial design or ongoing administration of the plan.

 Investments managed by participants.

 SEP contribution limited to 25% of Eligible Pay.

Simplified Employee Pension (SEP) Plans

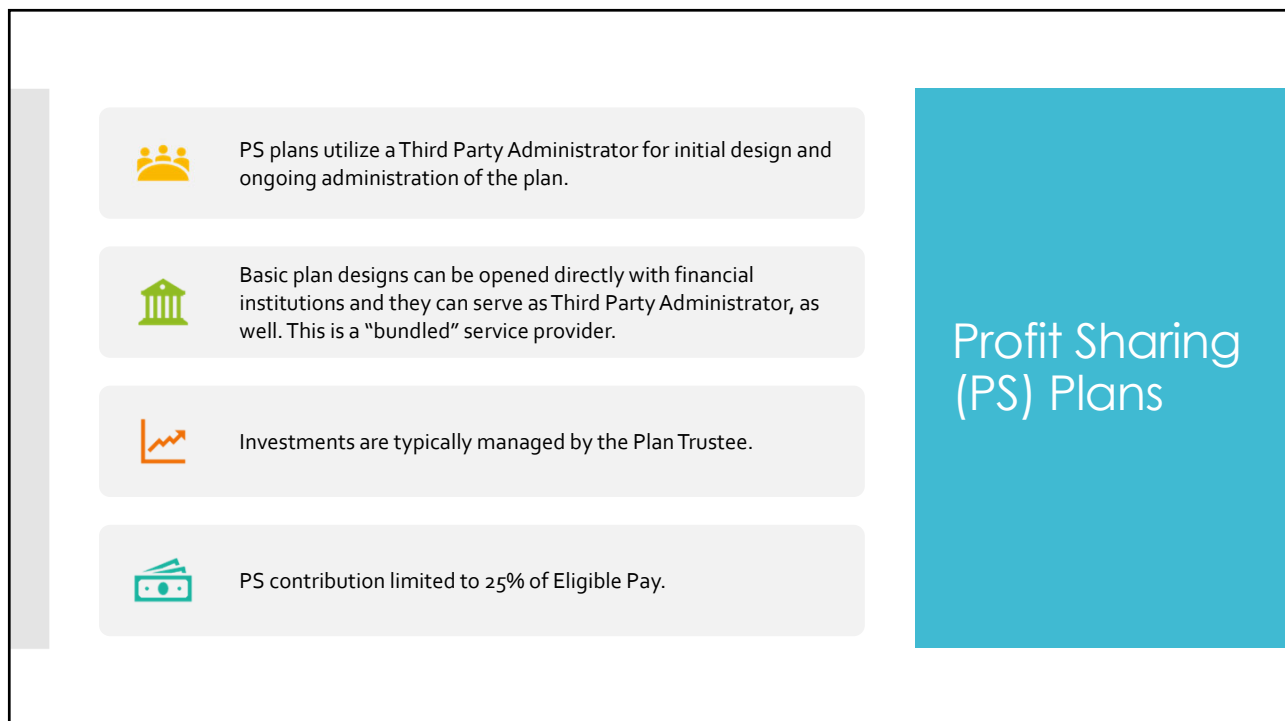
## Simplified Employee Pension (SEP) Plans

### ADVANTAGES

- Simple
- Low Cost – No Plan Document to maintain
- No 5500 to file





### DISADVANTAGES

- Administered by Employer (high potential for error/abuse)
- Must provide the same contribution % to ALL Eligible Employees, even owners
- Must cover all employees that have attained age 21 and received at least \$600/year in pay for at least 3 of the last 5 years
- Typically can't be paired with another plan
- No vesting schedules allowed



The infographic is titled "Profit Sharing (PS) Plans" in white text on a teal background. To the left of the title are four light gray rounded rectangular boxes, each containing an icon and a text description. The icons are: a group of three people, a classical building, a line graph with an upward arrow, and a stack of money.

**Profit Sharing (PS) Plans**

-  PS plans utilize a Third Party Administrator for initial design and ongoing administration of the plan.
-  Basic plan designs can be opened directly with financial institutions and they can serve as Third Party Administrator, as well. This is a "bundled" service provider.
-  Investments are typically managed by the Plan Trustee.
-  PS contribution limited to 25% of Eligible Pay.

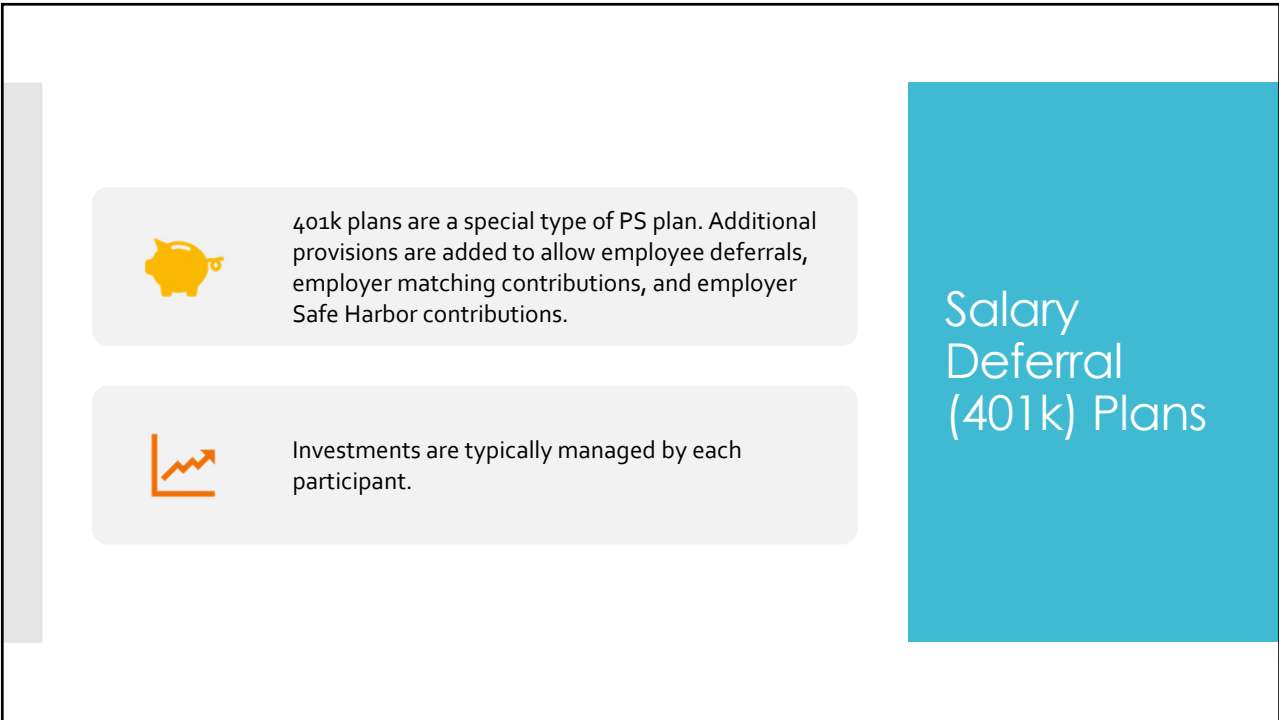
## Profit Sharing (PS) Plans

### ADVANTAGES



- PS allocation methods are more flexible than SEPs and can consider age as well as pay
- “Employee Classification” allocation method available, which allows different contribution rates for varying groups of participants
- Eligibility rules can be more restrictive than under a SEP
- Vesting schedule available

### DISADVANTAGES

- Typically not self-administered – a TPA is needed, therefore increasing the cost to maintain the plan



**Salary Deferral (401k) Plans**

-  401k plans are a special type of PS plan. Additional provisions are added to allow employee deferrals, employer matching contributions, and employer Safe Harbor contributions.
-  Investments are typically managed by each participant.

## Salary Deferral (401k) Plans

### ADVANTAGES

- Allow employees to contribute to their retirement accounts on a tax-favored basis
- Increases the total retirement contribution available to lower-paid small business owners
- Roth 401k Deferrals available regardless of the income level of the participant

### DISADVANTAGES

- Deferrals by Highly Compensated Employees are restricted by the average participation rate of other eligible participants (typically a +2% spread is allowed)
- Ongoing administration of the plan is more demanding and costly than a SEP or PS plan

## Safe Harbor (SH) 401k Plans

Special type of 401(k) Plan

### ADVANTAGES

- Employer can select one of two SH contribution options:
  - 3% of pay to all eligible employees, or
  - 100% match on 401k deferrals (capped at 4% of pay);
- HCEs are not required to receive a SH contribution, or accrual requirements for HCEs to receive the SH contribution can apply
- Plan automatically satisfies the traditional 401k (salary deferral) non-discrimination tests so HCE deferrals are not restricted

### DISADVANTAGES

- Employer must commit to a Safe Harbor contribution before the start of the Plan Year
- If employer terminates the SH provisions mid-year, the SH contribution must be funded for the portion of the year before it was removed, but the entire plan year may be subject to the traditional 401k (salary deferral) testing



SEP – Maximum					
	W-2 Pay	401k	SEP	Total	Payroll Taxes
Owner	228,000	N/A	57,000	57,000	23,687
Spouse	-	-	-	-	-
Total	228,000	N/A	57,000	57,000	23,687

401(k) - Maximum					
	W-2 Pay	401k	ER	Total	Payroll Taxes Diff
Owner	150,000	19,500	37,500	57,000	(2,262)
Spouse	-	-	-	-	-
Total	150,000	19,500	37,500	57,000	(2,262)

401k Plan requires less Pay to provide same benefits and SAVES about \$2,200 in payroll taxes

## SEP vs 401(k) Plan

Owner Only Illustration

## SEP vs 401(k) Plan

Adding Spouse

### SEP – Maximum to Owner & Spouse

	W-2 Pay	401k	ER	Total	Add'l Payroll Taxes
Owner	228,000	N/A	57,000	57,000	23,687
Spouse	228,000	N/A	57,000	57,000	23,687
<b>Total</b>	<b>456,000</b>	<b>-</b>	<b>114,000</b>	<b>114,000</b>	<b>47,374</b>

### 401(k) – Maximum to Owner & Spouse

	W-2 Pay	401k	ER	Total	Payroll Taxes Diff
Owner	243,000	19,500	37,500	57,000	435
Spouse	57,000	19,500	37,500	57,000	(14,966)
<b>Total</b>	<b>300,000</b>	<b>39,000</b>	<b>75,000</b>	<b>114,000</b>	<b>(14,531)</b>

401(k) Plan allows family to shelter same total contributions but with less pay, decreasing payroll taxes by about \$14,500

### 401(k) – Maximum to Owner Only

	W-2 Pay	401k	ER	Total	Payroll Taxes Diff
Owner	138,000	19,500	37,500	57,000	(2,610)
Spouse	22,000	19,500	2,500	22,000	(20,321)
<b>Total</b>	<b>160,000</b>	<b>39,000</b>	<b>40,000</b>	<b>79,000</b>	<b>(22,931)</b>

Alternative to pay spouse enough to shelter maximum 401(k) deferral

Pension plans are funded solely by the employer and investments are managed by the Trustee.

CB plans are a type of Defined Benefit plan that expresses the "benefit" as a Contribution Credit added to a participant's Hypothetical Account Balance

Contribution can exceed 25% of Pay

## Cash Balance (CB) Plans

## Cash Balance (CB) Plans

### ADVANTAGES

- Typically allows for much larger contributions than a 401(k) or Profit Sharing Plan
- Set credited interest rate (usually about 5%) allows clear projection of benefits
- Funding can be made within a Minimum/Maximum contribution range
- CB plans can be frozen if an amendment is adopted before participants work 1,000 hours in the plan year

### DISADVANTAGES

- Assets under pension plans generally do NOT equal benefits – This concept is difficult for plan sponsors to understand and remember
- CB Plans must be kept "open" for at least 5 years
- Most CB Plans are required to submit annual filings with the PBGC and pay annual premiums (Owner Only Plans are exempt)

## Cash Balance Lifetime Limit Factors



### Length of time in Plan

Lifetime Limit accrues over a 10-year period



### Rates & Mortality Tables

IRS interest rates and mortality tables updated annually

Higher interest rates and longer life expectancy typically decreases the limit

Lower interest rates and shorter life expectancy typically increases the limit



### Compensation

High 3-year average is used  
Maximum plan compensation for 2020 is \$285k – lower levels of pay may decrease lifetime limit



### Age at time of payout

Maximum lump sum available between ages 62-65  
Payout amounts are smaller at younger ages

Age at Payout	Lump Sum Max
45	\$1.3M
55	\$2.1M
65	\$2.8M

Cash  
Balance  
Lifetime Limit  
Factors



## CB Funding Strategies

### Sustainable Funding

"Level" contribution amount projected for expected life of Plan

- CB Plans can be designed to accommodate a desired "level" funding contribution (adjusted for gains based on actual investments)
- CB Plans assume a set interest rate and Hypothetical Account Balances grow with level Contribution Credits:

Age	Year	5% Interest	Contribution Credit*	Hypothetical Ending Balance
56	1	-	222,613	222,613
57	2	11,131	222,613	456,356
58	3	22,818	222,613	701,787
59	4	35,089	222,613	959,489
60	5	47,974	222,613	1,230,076
61	6	61,504	222,613	1,514,193
62	7	75,710	222,613	1,812,515
63	8	90,626	222,613	2,125,754
64	9	106,288	222,613	2,454,654
65	10	122,733	222,613	<b>2,800,000</b>

\*Based on max compensation



Pre-funding

Excessive funding to “front load” the Plan, which reduces future funding

- Contributing larger contributions can pre-fund the anticipated benefits that will accrue in future years (assuming plan investments experience positive returns).
- Pre-funding can reduce and/or eliminate the need to fund for future plan years.

Age	Year	Beginning Balance	6% Interest	Ending Balance	Hypothetical Acnt Bal*	Shortfall / (Pre-funding)	Receivable Deposit	Ending Bal with Rcvbl
56	1	-	-	-	222,613	222,613	330,000	330,000
57	2	330,000	19,800	349,800	456,356	106,556	330,000	679,800
58	3	679,800	40,788	720,588	701,787	(18,801)	330,000	1,050,588
59	4	1,050,588	63,035	1,113,623	959,489	(154,134)	300,000	1,413,623
60	5	1,413,623	84,817	1,498,441	1,230,076	(268,364)	300,000	1,798,441
61	6	1,798,441	107,906	1,906,347	1,514,193	(392,154)	300,000	2,206,347
62	7	2,206,347	132,381	2,338,728	1,812,515	(526,213)	-	2,338,728
63	8	2,338,728	140,324	2,479,052	2,125,754	(353,298)	-	2,479,052
64	9	2,479,052	148,743	2,627,795	2,454,654	(173,140)	-	2,627,795
65	10	2,627,795	157,668	2,785,462	2,800,000	14,538	-	2,785,462

\*Based on Sustainable Funding table

## CB Funding Strategies

### Funding Shortfall

Funding gap between benefits and plan assets to keep both "in sync"

- By comparing the Hypothetical Account Balance against the actual ending balance of investments each plan year, the funding shortfall can be the target contribution deposit to keep assets "in sync" with the CB benefits.

Age	Year	Beginning Balance	6% Interest	Ending Balance	Hypothetical Acnt Bal*	Shortfall / (Pre-funding)	Receivable Deposit	Ending Bal with Rcvbl
56	1	-	-	-	222,613	222,613	222,613	222,613
57	2	222,613	13,357	235,970	456,356	220,386	220,386	456,356
58	3	456,356	27,381	483,737	701,787	218,050	218,050	701,787
59	4	701,787	42,107	743,894	959,489	215,595	215,595	959,489
60	5	959,489	57,569	1,017,059	1,230,076	213,018	213,018	1,230,076
61	6	1,230,077	73,805	1,303,881	1,514,193	210,312	210,312	1,514,193
62	7	1,514,193	90,852	1,605,044	1,812,515	207,471	207,471	1,812,515
63	8	1,812,515	108,751	1,921,266	2,125,754	204,488	204,488	2,125,754
64	9	2,125,754	127,545	2,253,299	2,454,654	201,355	201,355	2,454,654
65	10	2,454,654	147,279	2,601,934	2,800,000	198,066	198,066	2,800,000

\*Based on Sustainable Funding table

### Freeze Plan

Benefits can be frozen, or decreased, during the year if adopted prior to earning the benefit (i.e. 1,000 hours of service)

## CB Funding Strategies

- Once benefits are frozen, Hypothetical Account Balances only increase by credited interest. Freezing/reducing benefits is a good way to significantly reduce or eliminate minimum contribution requirements and can help in low cash-flow years.

Age	Year	Beginning Balance	6% Interest	Ending Balance	Hypothetical Acnt Bal*	Shortfall / (Pre-funding)	Receivable Deposit	Ending Bal with Rcvbl
56	1	-	-	-	222,613	222,613	250,000	250,000
57	2	250,000	15,000	265,000	456,356	106,556	250,000	515,000
58	3	515,000	30,900	545,900	701,787	(18,801)	250,000	795,900
59	4	795,900	47,754	843,654	959,489	(154,134)	250,000	1,093,654
60	5	1,093,654	65,619	1,159,273	1,230,076	(268,364)	-	1,159,273
61	6	1,159,273	69,556	1,228,830	1,291,580	(392,154)	-	1,228,830
62	7	1,228,830	73,730	1,302,559	1,356,159	(526,213)	-	1,302,559
63	8	1,302,559	78,154	1,380,713	1,423,967	(353,298)	-	1,380,713
64	9	1,380,713	82,843	1,463,556	1,495,165	(173,140)	-	1,463,556
65	10	1,463,556	87,813	1,551,369	1,569,924	14,538	-	1,551,369

\*Based on Sustainable Funding table

- Pairing a 401(k) Plan with a CB Plan can increase the overall contributions sheltered.
- Owner Only 401(k) Plans are limited to a 6% employer contribution if paired with an “unfrozen” CB Plan.

Plan	401(k) Max Allowed ER Contribution	401(k) Plan ER Contribution	401(k) Plan EE Deferral	CB Plan ER Contribution	Total Contribution	Minimum Pay Needed
SEP	25%	57,000	-	-	57,000	228,000
401(k)	25%	37,500	19,500	-	57,000	150,000
CB	-	-	-	230,000	230,000	285,000
401(k) + CB	6%	17,100	19,500	230,000	266,600	285,000

## CB & 401(k) “Combo” Plan

thank  
you!

And a Very Special Thank You  
to  
Flynn, Shojinaga & Associates!



A person wearing a purple dress shirt and a dark tie is holding a white rectangular sign in front of their face. The sign features three large black question marks of varying sizes. The person's hands are visible at the top corners of the sign.

Follow up questions can be sent to  
[eugene@edemmler.com](mailto:eugene@edemmler.com)



**E. DEMMLER  
& ASSOCIATES**  
WEALTH MANAGEMENT

**Eugene C. Demmler, AIF™**

**Wealth Advisor, LPL Registered Principal**

1101 Marina Village Parkway, Suite 201

Alameda, CA 94501

[www.edemmler.com](http://www.edemmler.com)

510-865-1026, x22

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