

# **SAFE-HARBOR LEVERAGING FOR SMALL BUSINESS, TOP-HEAVY RETIREMENT PLANS**

Updated January, 2009

Many employers are debating how to most efficiently take advantage of the defined contribution limit increase to \$49,000. However, few owners of small businesses are aware of the extent to which certain types of “leveraging” are now permitted in qualified retirement plans. The purpose of this article is to illustrate the provisions that allow owners of small businesses to get the most in return for what they are willing to contribute on behalf of their non-owner employees.

In this article the word “leveraging” pertains to the ways a company can contribute a certain percent of pay for its non-owner employees, while allowing the owner to have a tax deduction of some higher percent of pay. The words “safe-harbor” pertain to the fact that these provisions can be used with automatic pre-approval from the federal government, and no concern for participants’ ages or other facts and circumstances. Also, safe-harbor plans can usually be adopted with lower fees for legal documents.

The qualified plans sponsored by small businesses are usually “top-heavy.” A plan is deemed top-heavy when over 60% of the assets are attributed to officers and shareholders. In such a case, the employer must allocate to each “non-key” employee / participant at least 3% of pay in order to contribute anything significant for the owners. This article is intended to explain the areas of leveraging that we typically recommend in top-heavy plans, as well as the results that can be obtained. Many of these provisions will even be of interest to sponsors of plans not required to make a top-heavy minimum contribution. The following are examples of leveraging allowed in qualified retirement plans, including two rules that have only been effect for the last few years:

**A) Permitted Disparity** (formerly called “integration with Social Security”) --- Every employer already sponsors one retirement plan called Social Security. However, when viewed as a percent of pay, both the FICA taxes paid by the company and the ultimate Social Security benefits discriminate against higher paid employees. For example, the company must pay the full 7.65% FICA tax for an employee making less than the Social Security taxable wage base (\$106,800 for 2008). But for an owner making twice the taxable wage base, the company’s FICA taxes paid on his behalf come to a much lower percent of his *total* pay. A private industry retirement plan is allowed to make up for this discrepancy by giving the higher paid participants a contribution which is a higher percent of their pay than is given to the lower paid employees. Many times, this permits the owner to get a contribution that is about 3% more than the percent he spends on lower paid participants in the same plan.

**B) Safe-Harbor 401(k) Plans** --- If an employer is willing to fully vest its top-heavy minimum 3% contribution in a top-heavy plan, then not only does the owner get that same 3% contribution, but he can defer an additional \$16,500 for 2009. This is permitted even if none of the other employees choose to utilize the 401(k) portion of the plan. Also, anyone over age 50 can defer an additional \$5,500 for the year 2009.

**C) Matching Contributions** --- Even without safe-harbor provisions, 401(k) plans are permitted, within limits, to have owners averaging a higher percent of pay matching contribution than the non-owners receive. With the safe-harbor provision described in the previous paragraph, a plan can have a discretionary match of up to 2/3 of the first 6% of pay contributed by the participant. This results in the owner getting a contribution of another 4% of pay, even if none of the other participants are contributing to the plan.

**D) Vesting Schedules** --- Much of the company contribution can usually be made subject to a vesting schedule, usually resulting in an even higher portion of the long-term contribution going to the owners.

The attached Tables illustrate what can be achieved by combining some or all of these leveraging rules. RMS can help employers choose the plan design that most efficiently achieves these results.

**Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans**

Table 1

What % of Pay is the Employer Willing to Contribute for the Lower Paid Employees?	What % of Pay is Expected to be Contributed by the Lower Paid Employees?	OWNER'S ANNUAL PAY												
		\$125,000	\$135,000	\$145,000	\$155,000	\$165,000	\$175,000	\$185,000	\$195,000	\$205,000	\$215,000	\$225,000	\$235,000	\$245,000
		CONTRIBUTION PERCENT THAT CAN BE ACHIEVED FOR THE OWNER												
3%	0%	20%	19%	18%	18%	17%	16%	16%	15%	15%	15%	14%	14%	14%
	2%	16%	15%	14%	14%	13%	12%	12%	11%	11%	11%	10%	10%	10%
	4%	16%	15%	14%	14%	13%	12%	12%	11%	11%	11%	10%	10%	10%
	6%	16%	15%	14%	14%	13%	12%	12%	11%	11%	11%	10%	10%	10%
4%	0%	22%	21%	20%	19%	19%	18%	17%	17%	17%	16%	16%	16%	15%
	2%	19%	18%	17%	17%	16%	15%	15%	14%	14%	14%	13%	13%	13%
	4%	18%	17%	16%	15%	15%	14%	13%	13%	13%	12%	12%	12%	11%
	6%	18%	17%	16%	15%	15%	14%	13%	13%	13%	12%	12%	12%	11%
5%	0%	23%	22%	21%	21%	20%	19%	19%	19%	18%	18%	18%	17%	17%
	2%	21%	20%	19%	19%	18%	17%	17%	17%	16%	16%	15%	15%	15%
	4%	19%	18%	17%	17%	16%	15%	15%	15%	14%	14%	14%	13%	13%
	6%	19%	18%	17%	17%	16%	15%	15%	15%	14%	14%	14%	13%	13%
6%	0%	25%	24%	23%	22%	22%	21%	21%	20%	20%	19%	19%	19%	19%
	2%	23%	22%	21%	20%	20%	19%	18%	18%	18%	17%	17%	17%	16%
	4%	21%	20%	19%	18%	18%	17%	17%	16%	16%	15%	15%	15%	15%
	6%	21%	20%	19%	18%	18%	17%	17%	16%	16%	15%	15%	15%	15%
7%	0%	26%	25%	24%	24%	23%	22%	22%	22%	21%	21%	21%	21%	20%
	2%	24%	23%	22%	22%	21%	20%	20%	20%	19%	19%	19%	18%	18%
	4%	22%	21%	20%	20%	19%	18%	18%	18%	17%	17%	17%	17%	16%
	6%	22%	21%	20%	20%	19%	18%	18%	18%	17%	17%	17%	17%	16%
8%	0%	27%	26%	26%	25%	24%	24%	24%	23%	23%	23%	22%	21%	20%
	2%	26%	25%	24%	23%	23%	22%	22%	21%	21%	21%	20%	20%	20%
	4%	24%	23%	22%	21%	21%	20%	20%	19%	19%	19%	18%	18%	18%
	6%	23%	22%	22%	21%	20%	20%	20%	19%	19%	19%	18%	18%	18%
9%	0%	28%	27%	27%	26%	25%	25%	25%	24%	24%	23%	22%	21%	20%
	2%	27%	26%	25%	25%	24%	23%	23%	23%	22%	22%	22%	21%	20%
	4%	25%	24%	23%	23%	22%	21%	21%	21%	20%	20%	20%	20%	20%
	6%	24%	23%	23%	22%	21%	21%	21%	20%	20%	20%	20%	19%	19%
10%	0%	29%	28%	28%	27%	26%	26%	26%	25%	24%	23%	22%	21%	20%
	2%	28%	27%	26%	26%	25%	24%	24%	24%	24%	23%	22%	21%	20%
	4%	27%	26%	25%	24%	24%	23%	23%	22%	22%	22%	21%	21%	20%
	6%	25%	24%	24%	23%	22%	22%	22%	21%	21%	21%	21%	20%	20%
11%	0%	30%	29%	29%	28%	27%	27%	26%	25%	24%	23%	22%	21%	20%
	2%	29%	28%	27%	27%	26%	25%	25%	25%	24%	23%	22%	21%	20%
	4%	28%	27%	26%	25%	25%	24%	24%	24%	23%	23%	22%	21%	20%
	6%	26%	25%	25%	24%	23%	23%	23%	22%	22%	22%	22%	21%	20%
12%	0%	31%	30%	30%	29%	28%	28%	26%	25%	24%	23%	22%	21%	20%
	2%	30%	29%	28%	28%	27%	26%	26%	25%	24%	23%	22%	21%	20%
	4%	29%	28%	27%	26%	26%	25%	25%	25%	24%	23%	22%	21%	20%
	6%	27%	26%	26%	25%	24%	24%	24%	23%	23%	23%	22%	21%	20%

**Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans**

Table 2

What % of Pay is the Employer Willing to Contribute for the Lower Paid Employees?	What % of Pay is Expected to be Contributed by the Lower Paid Employees?	OWNER'S ANNUAL PAY												
		\$125,000	\$135,000	\$145,000	\$155,000	\$165,000	\$175,000	\$185,000	\$195,000	\$205,000	\$215,000	\$225,000	\$235,000	\$245,000
		CONTRIBUTION AMOUNT THAT CAN BE ACHIEVED FOR THE OWNER												
3%	0%	25,200	25,900	26,600	27,300	28,000	28,700	29,400	30,100	30,800	31,500	32,200	32,900	33,600
	2%	20,200	20,500	20,800	21,100	21,400	21,700	22,000	22,300	22,600	22,900	23,200	23,500	23,800
	4%	20,200	20,500	20,800	21,100	21,400	21,700	22,000	22,300	22,600	22,900	23,200	23,500	23,800
	6%	20,200	20,500	20,800	21,100	21,400	21,700	22,000	22,300	22,600	22,900	23,200	23,500	23,800
4%	0%	27,100	28,000	28,800	29,700	30,500	31,400	32,200	33,100	34,000	34,900	35,800	36,700	37,600
	2%	24,000	24,600	25,200	25,800	26,400	27,000	27,600	28,200	28,800	29,400	30,000	30,600	31,200
	4%	22,100	22,600	23,000	23,500	23,900	24,400	24,800	25,300	25,800	26,300	26,800	27,300	27,800
	6%	22,100	22,600	23,000	23,500	23,900	24,400	24,800	25,300	25,800	26,300	26,800	27,300	27,800
5%	0%	29,000	30,000	31,000	32,000	33,000	34,000	35,100	36,200	37,300	38,400	39,500	40,600	41,700
	2%	26,500	27,300	28,100	28,900	29,700	30,500	31,300	32,100	33,000	33,800	34,600	35,500	36,300
	4%	24,000	24,600	25,200	25,800	26,400	27,000	27,700	28,400	29,100	29,800	30,500	31,200	31,900
	6%	24,000	24,600	25,200	25,800	26,400	27,000	27,700	28,400	29,100	29,800	30,500	31,200	31,900
6%	0%	30,900	32,100	33,200	34,400	35,500	36,700	37,900	39,200	40,500	41,800	43,100	44,400	45,700
	2%	28,400	29,300	30,300	31,200	32,200	33,100	34,100	35,200	36,200	37,200	38,300	39,300	40,300
	4%	25,900	26,700	27,400	28,200	28,900	29,700	30,500	31,400	32,300	33,200	34,100	35,000	35,900
	6%	25,900	26,700	27,400	28,200	28,900	29,700	30,500	31,400	32,300	33,200	34,100	35,000	35,900
7%	0%	32,800	34,100	35,400	36,700	38,000	39,300	40,800	42,300	43,800	45,300	46,800	48,300	49,000
	2%	30,300	31,400	32,500	33,600	34,700	35,800	37,000	38,200	39,500	40,700	41,900	43,200	44,400
	4%	27,800	28,700	29,600	30,500	31,400	32,300	33,400	34,500	35,600	36,700	37,800	38,900	40,000
	6%	27,800	28,700	29,600	30,500	31,400	32,300	33,400	34,500	35,600	36,700	37,800	38,900	40,000
8%	0%	34,200	35,700	37,100	38,500	39,900	41,300	43,600	45,300	47,000	48,700	49,000	49,000	49,000
	2%	32,200	33,400	34,700	35,900	37,200	38,400	39,800	41,300	42,700	44,100	45,600	47,000	48,400
	4%	29,700	30,700	31,800	32,800	33,900	34,900	36,200	37,500	38,800	40,100	41,400	42,700	44,000
	6%	29,200	30,300	31,300	32,300	33,300	34,300	36,200	37,500	38,800	40,100	41,400	42,700	44,000
9%	0%	35,500	37,000	38,500	40,000	41,600	43,100	45,900	47,700	49,000	49,000	49,000	49,000	49,000
	2%	33,800	35,200	36,600	38,000	39,400	40,700	42,700	44,300	45,900	47,600	49,000	49,000	49,000
	4%	31,600	32,800	34,000	35,200	36,400	37,600	39,000	40,500	42,000	43,400	44,900	46,400	47,900
	6%	30,500	31,600	32,700	33,800	35,000	36,100	38,500	39,900	41,400	42,800	44,200	45,700	47,100
10%	0%	36,700	38,400	40,000	41,600	43,200	44,800	47,700	49,000	49,000	49,000	49,000	49,000	49,000
	2%	35,100	36,600	38,000	39,500	41,000	42,500	45,300	47,100	48,900	49,000	49,000	49,000	49,000
	4%	33,400	34,800	36,100	37,500	38,800	40,200	41,800	43,400	45,000	46,700	48,300	49,000	49,000
	6%	31,700	33,000	34,200	35,400	36,600	37,800	40,300	41,900	43,400	44,900	46,500	48,000	49,000
11%	0%	38,000	39,700	41,400	43,100	44,900	46,600	49,000	49,000	49,000	49,000	49,000	49,000	49,000
	2%	36,300	37,900	39,500	41,100	42,700	44,200	47,100	49,000	49,000	49,000	49,000	49,000	49,000
	4%	34,700	36,100	37,600	39,000	40,500	41,900	44,600	46,400	48,100	49,000	49,000	49,000	49,000
	6%	33,000	34,300	35,600	36,900	38,300	39,600	42,200	43,800	45,500	47,100	48,700	49,000	49,000
12%	0%	39,200	41,100	42,900	44,700	46,500	48,300	49,000	49,000	49,000	49,000	49,000	49,000	49,000
	2%	37,600	39,300	40,900	42,600	44,300	46,000	49,000	49,000	49,000	49,000	49,000	49,000	49,000
	4%	35,900	37,500	39,000	40,600	42,100	43,700	46,500	48,400	49,000	49,000	49,000	49,000	49,000
	6%	34,200	35,700	37,100	38,500	39,900	41,300	44,000	45,800	47,500	49,000	49,000	49,000	49,000

**Safe-Harbor Leveraging for Small Business Top-Heavy Retirement Plans**

Table 3

What % of Pay is the Employer Willing to Contribute for the Lower Paid Employees?	What % of Pay is Expected to be Contributed by the Lower Paid Employees?	OWNER'S ANNUAL PAY												
		\$125,000	\$135,000	\$145,000	\$155,000	\$165,000	\$175,000	\$185,000	\$195,000	\$205,000	\$215,000	\$225,000	\$235,000	\$245,000
		RATIO OF OWNER'S CONTRIBUTION PERCENT TO THE EMPLOYER COST FOR LOWER PAID PARTICIPANTS												
3%	0%	6.7	6.4	6.1	5.9	5.7	5.5	5.3	5.2	5.0	4.9	4.8	4.7	4.6
	2%	5.4	5.1	4.8	4.5	4.3	4.1	4.0	3.8	3.7	3.6	3.4	3.3	3.2
	4%	5.4	5.1	4.8	4.5	4.3	4.1	4.0	3.8	3.7	3.6	3.4	3.3	3.2
	6%	5.4	5.1	4.8	4.5	4.3	4.1	4.0	3.8	3.7	3.6	3.4	3.3	3.2
4%	0%	5.4	5.2	5.0	4.8	4.6	4.5	4.4	4.3	4.2	4.1	4.0	3.9	3.8
	2%	4.8	4.6	4.3	4.2	4.0	3.9	3.7	3.6	3.5	3.4	3.3	3.3	3.2
	4%	4.4	4.2	4.0	3.8	3.6	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.8
	6%	4.4	4.2	4.0	3.8	3.6	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.8
5%	0%	4.6	4.5	4.3	4.1	4.0	3.9	3.8	3.7	3.6	3.6	3.5	3.5	3.4
	2%	4.2	4.0	3.9	3.7	3.6	3.5	3.4	3.3	3.2	3.1	3.1	3.0	3.0
	4%	3.8	3.7	3.5	3.3	3.2	3.1	3.0	2.9	2.8	2.8	2.7	2.7	2.6
	6%	3.8	3.7	3.5	3.3	3.2	3.1	3.0	2.9	2.8	2.8	2.7	2.7	2.6
6%	0%	4.1	4.0	3.8	3.7	3.6	3.5	3.4	3.4	3.3	3.2	3.2	3.2	3.1
	2%	3.8	3.6	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.9	2.8	2.8	2.7
	4%	3.5	3.3	3.2	3.0	2.9	2.8	2.8	2.7	2.6	2.6	2.5	2.5	2.4
	6%	3.5	3.3	3.2	3.0	2.9	2.8	2.8	2.7	2.6	2.6	2.5	2.5	2.4
7%	0%	3.8	3.6	3.5	3.4	3.3	3.2	3.2	3.1	3.1	3.0	3.0	2.9	2.9
	2%	3.5	3.3	3.2	3.1	3.0	2.9	2.9	2.8	2.8	2.7	2.7	2.6	2.6
	4%	3.2	3.0	2.9	2.8	2.7	2.6	2.6	2.5	2.5	2.4	2.4	2.4	2.3
	6%	3.2	3.0	2.9	2.8	2.7	2.6	2.6	2.5	2.5	2.4	2.4	2.4	2.3
8%	0%	3.4	3.3	3.2	3.1	3.0	3.0	3.0	2.9	2.9	2.8	2.7	2.6	2.5
	2%	3.2	3.1	3.0	2.9	2.8	2.7	2.7	2.6	2.6	2.6	2.5	2.5	2.5
	4%	3.0	2.9	2.7	2.7	2.6	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.2
	6%	2.9	2.8	2.7	2.6	2.5	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.2
9%	0%	3.2	3.1	3.0	2.9	2.8	2.7	2.8	2.7	2.7	2.5	2.4	2.3	2.2
	2%	3.0	2.9	2.8	2.7	2.7	2.6	2.6	2.5	2.5	2.5	2.4	2.3	2.2
	4%	2.8	2.7	2.6	2.5	2.5	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.2
	6%	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.2	2.1
10%	0%	2.9	2.8	2.8	2.7	2.6	2.6	2.6	2.5	2.4	2.3	2.2	2.1	2.0
	2%	2.8	2.7	2.6	2.6	2.5	2.4	2.4	2.4	2.4	2.3	2.2	2.1	2.0
	4%	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.0
	6%	2.5	2.4	2.4	2.3	2.2	2.2	2.2	2.1	2.1	2.1	2.1	2.0	2.0
11%	0%	2.8	2.7	2.6	2.5	2.5	2.4	2.4	2.3	2.2	2.1	2.0	1.9	1.8
	2%	2.6	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.2	2.1	2.0	1.9	1.8
	4%	2.5	2.4	2.4	2.3	2.2	2.2	2.2	2.2	2.1	2.1	2.0	1.9	1.8
	6%	2.4	2.3	2.2	2.2	2.1	2.1	2.1	2.1	2.0	2.0	2.0	1.9	1.8
12%	0%	2.6	2.5	2.5	2.4	2.4	2.3	2.2	2.1	2.0	1.9	1.8	1.7	1.7
	2%	2.5	2.4	2.4	2.3	2.2	2.2	2.2	2.1	2.0	1.9	1.8	1.7	1.7
	4%	2.4	2.3	2.2	2.2	2.1	2.1	2.1	2.1	2.0	1.9	1.8	1.7	1.7
	6%	2.3	2.2	2.1	2.1	2.0	2.0	2.0	2.0	1.9	1.9	1.8	1.7	1.7