



The Law Offices of

R. David Danziger

TAX-ADVANTAGED RETIREMENT PLAN DESIGN & CONSULTING

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## CASE STUDY: TAX-QUALIFIED 401(K) PLAN, WITH MUCH OF THE FLEXIBILITY OF A NON-QUALIFIED PLAN

Much has been said about the benefits of non-qualified retirement plans for executives: ultimate flexibility, no dollar limits on amounts deferred by participants, minimal government regulation, etc. However, two negatives of non-qualified plans are: (1) contributions are not tax-deductible at the plan sponsor level; and (2) since the assets are the property of the company, there is no guarantee that they won't be forfeited in the event of a bankruptcy.

In today's world, however, it is possible to implement a tax-qualified 401(k)/profit sharing plan that has much of the flexibility of a non-qualified plan. Let's explore

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how one company was able to make this dream a reality.

Our client, William Gatesmith, founded a successful software company, MagnaSoft Incorporated (names have been changed to protect client confidentiality). When William retained The Law Offices of R. David Danziger, he had a prototype 401(k) profit sharing plan, under

which only an employer matching contribution was being provided. As a result, out of a total company contribution of almost \$70,000 (for 70 employees), William received only a \$5,000 employer match. He consulted with us to determine whether there was a way that more money could be contributed on his behalf in the 401(k) profit sharing plan without breaking the bank for the other 69 employees.

It's a predicament that many companies using prototype 401(k) plans face. The company would like to deliver more retirement benefits to its key employees, but how can this be accomplished within the confines of an inflexible plan document?

The Law Offices of R. David Danziger recommended that the client adopt a One Category Per Participant plan design. With this design, MagnaSoft was able to provide William with an additional \$28,000 in retirement savings via a year-end profit sharing contribution. This was in addition to his personal deferrals of \$13,000. The upshot: in order to avoid failing the IRS discrimination test, the cost, to the company, of

this additional contribution for William was a mere \$4,500 for the company's other 69 employees.

The value to William and to MagnaSoft is clearly evident. If the firm were to pay 35% corporate taxes on the total incremental retirement plan contributions of \$32,500 (\$28,000 for William, \$4,500 for all other employees), it would have resulted in over \$11,000 of additional payments to Uncle Sam. Instead, by spending \$4,500 on contributions for non-key employees, William is able to receive another \$28,000 of deferred income, and the company incurs no tax liability.

Another benefit of this "extreme flexibility" is that the additional contributions can be delivered to any of the firm's rank and file employees, providing MagnaSoft with the opportunity to reward high-performing staff members. One word of caution— the additional contribution may exceed \$4,500 for MagnaSoft if higher-paid employees are selected for these profit sharing "pre-tax bonuses".

William was so delighted that he asked us whether we could achieve similar results for Allen Paul, his chief executive officer,

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*A nationally known author and speaker, R. David Danziger Esq. has been quoted in the Wall Street Journal, & Lawyers Weekly*

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who was responsible for much of the company's success. The result: an OCPP design provided William and Allen with an additional \$28,000 each of profit sharing contributions at a total cost of \$8,000.

Now, thinking in much grander terms, William asked us what it would take to provide similar benefits for the entire 7-person management team in a year when financial results supported it. In essence, nearly \$160,000 of benefits can be provided to the management group at a cost of approximately \$61,000 for the remaining 63 employees. William appreciated this analysis and so far, the company

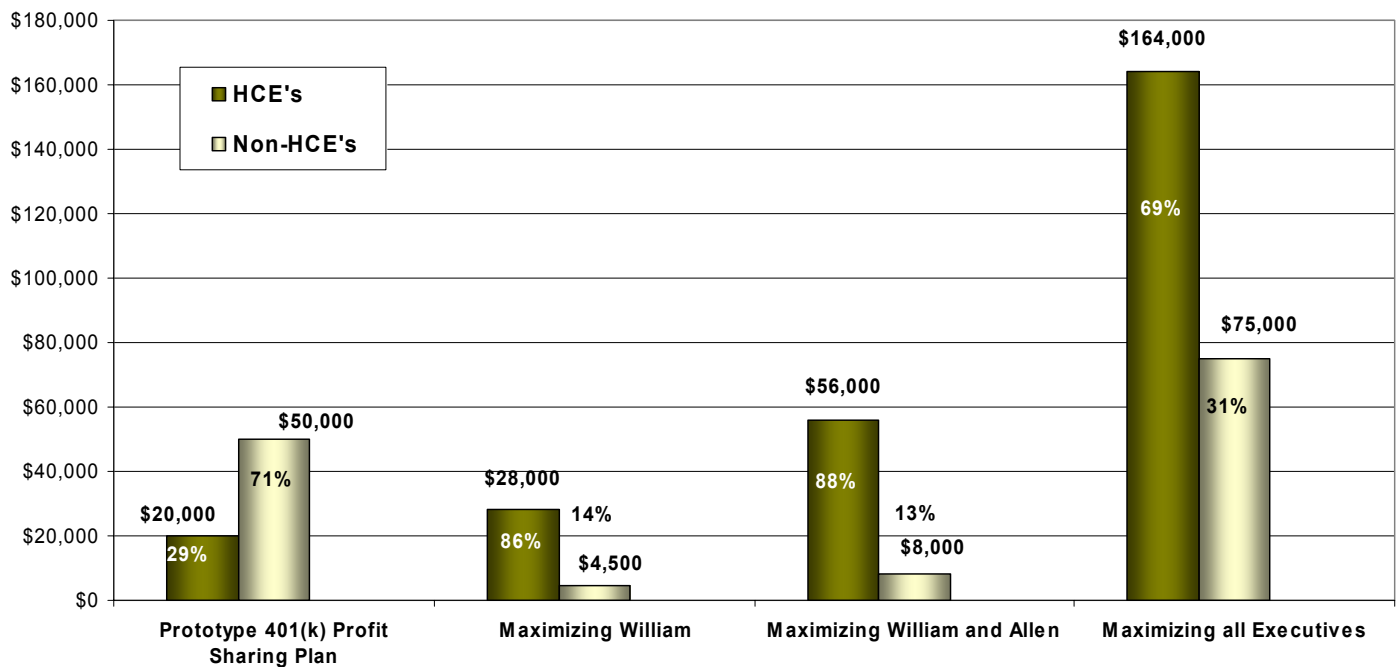
has kept this idea in its "back pocket." To date, 2005 results have been great. If results continue at the same pace, William's senior team will have happy smiles on their faces come year-end. In essence, William has a new tool to shelter taxes while rewarding his employees and helping them to save for retirement.

Today, MagnaSoft benefits from the extreme flexibility of an OCPP plan design: the level of contributions can be set at the end of each year after determining the company's profitability, and contributions can be targeted to any employee the company chooses, including highly-compensated and rank and file. At the same time, these profit sharing contributions are tax-deductible

to the company, the income is tax-deferred to the recipient, and the investments are held in the plan's secure trust fund. In short, the plan design delivers the best features of a non-qualified retirement plan, while retaining all of the advantages of a qualified plan.

The One Category Per Participant plan design has been approved by the Internal Revenue Service. This design can provide creative solutions to organizations of any size to help deliver retirement benefits to those most responsible for the success of the business. Please contact us to discuss your retirement plan issues.

### MagnaSoft Plan Design Comparison



**To learn more about our OCPP plan designs or retirement planning in general, please contact us at:**

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