

# New Comparability and Age-Weighted Plans

## A Story Worth Telling

Founded in 1905, The Lafayette Life Insurance Company is headquartered in Lafayette, Indiana. The company's Qualified Markets Department offers administrative services for Defined Benefit, Money Purchase, Target Benefit, Profit Sharing and 401(k) Plans. These services include plan design, funding, trust documents, and preparation of government reports. The Lafayette Life specializes in providing innovative plan design for the small business, including cross-tested profit sharing plans. An experienced and professional staff is prepared to assist you with your retirement objectives. The Lafayette Life also markets a portfolio of traditional and group life insurance in 48 states and the District of Columbia.

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## Isn't It About Time?

IRS regulations have come to the rescue of the small business! Owners have more flexibility with retirement plans than in the past.

Profit sharing plans have long been the retirement plan of choice for the small business. However, with "traditional" plans, flexibility exists only in the contribution level. Typically, each employee's share of the firm's contribution is identical. If one employee receives an allocation of 10 percent of salary, all employees receive an allocation of 10 percent of salary.

Most small business owners would like more options in the amount of their contribution to employees. Flexibility is now available. Section 401(a)(4) of the Internal Revenue Code allows profit sharing allocations to be divided differently among employees based upon identifiable classification groups. Not only is the amount of contribution flexible, but there is flexibility in the way it is divided among the employees.

This type of profit sharing plan is referred to as a "cross-tested" profit sharing plan. There are two types:

- Age-weighted plans, in which older employees are favored, and
- New Comparability plans, in which employees are divided into groups, with each group receiving a different share of the contribution.

The New Comparability profit sharing plan allows the owner to decide who will benefit more from the firm's profit sharing contribution based upon objective criteria. For example, the owner may divide employees by job classification, salary level, length of service or various combinations of these.

Once the desired allocations are decided, the plan is tested for nondiscrimination under Section 401(a)(4) of the Internal Revenue Code. If the projected benefits of the participants are "comparable" according to IRS guidelines, the plan is deemed to be nondiscriminatory. The age, compensation and contribution amount for each employee will determine whether the plan is discriminatory. These plans generally work well if the owner or key employees are older than most of the other employees.





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The options for classification groups and contribution amounts maximize the effectiveness of the firm's retirement plan using a New Comparability plan design. The example shown below illustrates the difference between the traditional profit sharing allocation and the New Comparability allocation.

Employee	Age	Salary	Traditional Profit Sharing Allocation	Percent of Total Contribution	New Comparability Profit Sharing Allocation	Percent of Total Contribution
Owner	60	210,000	30,365	63.1	42,000	87.2
Employee A	33	35,000	5,061	10.5	1,750	3.6
Employee B	34	33,000	4,771	9.9	1,650	3.4
Employee C	54	30,000	4,338	9.0	1,500	3.1
Employee D	42	25,000	3,615	7.5	1,250	2.7
Total		333,000	48,150	100%	48,150	100%

Chart reflects cost of living adjustment effective 1/1/05

### Questions and Answers

Q. *How is a traditional profit sharing plan contribution allocated among the employees?*

A. Generally, all employees receive the same percentage of salary as their share of the contribution. No particular employee can be favored because of their salary level, age, length of service, or contribution to the profits of the business.

Q. *What is a cross-tested profit sharing plan?*

A. Cross-tested plans may be age-weighted or New Comparability. Nondiscrimination is tested by comparing benefit projections of participants rather than contribution levels. Thus, participants are not allocated the same percentage of salary.

Q. *What is an Age Weighted profit sharing plan?*

A. A plan allocating the contribution on the basis of age that favors older employees.

Q. *What is a New Comparability profit sharing plan?*

A. This type of plan allows more flexibility than an age-weighted plan. Employees are divided into classification groups and each class may receive an allocation different than the others. Two or three groups may be created with each group receiving a different allocation. There are many possibilities. The advantage of this plan design is the allocation flexibility previously unavailable within a traditional profit sharing plan.

Q. *Can a firm change an existing traditional profit sharing plan to a cross-tested plan?*

A. Yes. Usually the plan can be amended to change the allocation formula to a cross-tested plan. The existing plan is not terminated; only the method of allocation is amended.



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*Q. Should every existing profit sharing plan change to a cross-tested plan?*

A. Whether a cross-tested plan would be appealing to a business depends upon two factors. The objective of the employer is of primary importance. If the owner wants all employees to receive the same percentage of pay as their share of the profit sharing contribution, then a traditional plan will accomplish this. If, however, the owner prefers that not everyone receive the same share, the options available under these plans are significant.

The options will depend upon the demographics of any specific employee group. The ages and salaries of the employees will determine what type of plan design will pass the IRS's nondiscrimination testing. Usually, more desirable options are available if the owner or key employees are older than most of the other employees.

*Q. How do I evaluate a cross-tested profit sharing plan for my business?*

A. First, you need to meet with a Lafayette Life Insurance Company representative. The representative will collect census data and other pertinent information. A retirement plan proposal will be prepared based upon your objectives and funding goals.

*Q. Who is included in a profit sharing plan?*

A. The eligibility requirements generally are: employees must be 21 years old, and have one year of service that included 1,000 hours. Once employees have met the eligibility requirements, they are included in the plan.

*Q. Do profit sharing plans have a vesting schedule?*

A. Yes. One of the advantages of a qualified retirement plan is the vesting schedule. Most plans use a vesting schedule that requires employees to work for an employer a specified period, such as six years, before they are 100 percent vested. If a participant's employment is terminated before they are vested, the nonvested portion of their account is forfeited and remains in the plan.

*Q. How do I start a profit sharing plan?*

A. The steps are:

1. Review the retirement plan proposal presented by your Lafayette Life representative
2. Adopt the plan by signing the Adoption Agreement
3. Fund the plan

*Q. Why should I select Lafayette Life?*

A. **The Lafayette Life Insurance Company** is not a newcomer to qualified retirement plans. We have been providing services and funding products for over 30 years.

The advantages that we offer are:

- One service provider for the plan document, funding, annual valuation and federal filings
- Consultation and evaluation by an experienced pension staff
- Your local representative services the account

The Lafayette Life Insurance Company provides services in connection to pension plans as outlined in a separate Services Agreement, and issues life insurance and annuity products that may be used as funding options. Lafayette Life does not serve as a plan administrator, nor does it provide legal or tax advice. This material is not to be relied upon for legal or tax advice. Your personal or legal advisors should always be consulted.