Tulsa Chapter – Oklahoma Society of CPAs

Retirement Plans:
Creative Plan Design
and
Minimizing Fiduciary Liability

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Agenda

- 2018 Retirement Plan Limits
- Creative Plan Design
- Minimizing Fiduciary Liability

2018 Limits - Increases

• Deferrals: 401(k), 403(b), 457(b)	$ 18,500
• DC plan 415 annual addition	$ 55,000
• DB plan 415 annual benefit	$220,000
• Compensation	$275,000
• SS wage base	$128,700

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2018 Limits – No Increases

• 401(k) Catch-up (age 50)	$ 6,000
• Comp for HCE definition	$120,000
• SIMPLE-IRA contribution	$ 12,500
• SIMPLE-IRA catch-up	$ 3,000

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2018 Limits – Impact

- Widens the advantage of 401(k) over SIMPLE
- Might hurt non-discrim testing if more HCEs
- Higher deferral limit is good for all savers
- Higher DC and DB 415 limits are beneficial primarily for owners and higher paid employees: larger tax deductions and benefits (e.g. Cash Balance plans)

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2018 Limits – Maximize Owner

Assume Safe Harbor 401(k) plan with cross-tested profit sharing:

401(k) deferral	$ 18,500
401(k) catch-up	$ 6,000
Safe Harbor 3% non-elective	$ 8,250
Profit Sharing (cross-tested)	$ 28,250
Total	$ 61,000
% of compensation ($275k)	22%

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2018 Limits - Saver's Tax Credit

- Tax deduction + tax credit
- On contributions up to $2,000: 401(k), 403(b), IRAs, SIMPLE-IRAs

tax credit	joint AGI	single AGI
50%	<$38k	<$19k
20%	$38-41k	$19k-20.5k
10%	$41-63k	$20.5k-31.5
0%	>$63k	>$31.5k

Creative Plan Design:
Safe Harbor 401(k) + Cross-tested Profit Sharing

- Outcome:
  - Maximum to Owner: $61,000 per year (22% of comp)
  - Minimum to employees: 5% of pay (including 3% Safe Harbor) but could be greater depending on ages and compensation levels
- Works best if Owner is 10 years older than average employees.
- Option to contribute more than minimum for certain groups or individuals; e.g. key employees.

Creative Plan Design: Safe Harbor 401(k) + Triple Stack Match

- Outcome:
  - Maximum to Owner: $61,000 per year (22% of comp)
  - Possible match to employees: 221% match on 6% of comp or 13% of comp overall
- Matching Stacks/Tiers:
  1. Safe Harbor: 100% on 4% of comp; 100% vested
  2. Fixed: 90% on 6% of comp; subject to vesting
  3. Discretionary: 65% on 6%; subject to vesting
- Attractive if Owner is younger than employees
- Works best for small employee groups with low compensation and low participation

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Creative Plan Design: Safe Harbor 401(k) + Cross-tested Profit Sharing + Cash Balance Plan

- Outcome:
  - Large deductions and funding for Owner; e.g. $220,000+ Maximum to age 55 Owner
  - Minimum to employees: 7.5%-10% of pay (including 3% Safe Harbor) but could be greater depending on ages and compensation levels
- Works best if Owner is 10 years older than average employees.
- Option to contribute more than minimum for certain groups or individuals; e.g. key employees.
- Cash Balance plan is a defined benefit plan.

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Creative Plan Design: Deferred Compensation Plans

- Purposes:
  - Supplement a qualified plan
  - Attract, retain, and reward key employees
  - Part of Owner’s exit strategy
- Not subject to ERISA; limit to select group
- Flexible, customized design for each employee
- Subject to claims of Employer’s creditors
- Postpone Employer’s tax deduction

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Creative Plan Design: ESOP as Owner's Exit Strategy

- C-corp:
  - Owner can defer or eliminate taxable gain on sale
  - Tax deductions for contributions to buy stock, dividends, p&i payments on ESOP loan
- S-corp:
  - No tax on pass-through income
  - No benefit in ESOP to owners and family
- Tax-deductible contributions to buy stock and pay dividends
- Retains legacy, culture, employees
- Creates market for future Owners
- Can be motivation for employees: stock value and dividends
- Need other Owners or key employees to continue; pair with deferred comp plan
- Repurchase obligation, costs, complexities, stock valuations

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Creative Plan Design: Non-standard Investments

- Real estate and non-publicly traded securities
- Allowable but critical to avoid compliance problems:
  - Prohibited transactions and excise tax
  - Self-dealing
  - Unrelated Business Taxable Income
  - Discrimination in favor of HCEs
  - Fidelity bonding and independent audit
  - Custodian to hold assets
  - Valuations and tax reporting for distributions
  - Capital calls

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Creative Plan Design: In-Plan Roth Conversions

- Pay current income tax on any portion of the Plan account
- Plan must offer Roth deferral option
- Wait to see if tax rates decline soon?
- Attractive if expect future large investment appreciation or higher tax rates

Creative Plan Design: EACA and QACA

- Automatic Contribution Arrangements: Increase participation for all and higher benefits for HCEs
- Tracking, notices, employee misunderstanding, increased cost of match
- EACA: flexible automatic, not Safe Harbor
- QACA: automatic min 3%/max 10%, req'd escalation to 6%, Safe Harbor w/2 yr vesting, Employer contribution 100% on 1% of comp + 50% on next 5% of comp

Fiduciary Liability: Who is a fiduciary?

- Employer as Plan Sponsor
- Plan Administrator (typically: the Employer)
- Trustee
- Other functional fiduciaries – individuals who exercise discretion or control over the plan (personal liability)
- Investment and administration co-fiduciaries (Note a fiduciary may be liable for another fiduciary’s breach if participate, conceal, or fail to correct)

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Fiduciary Liability: Definition of a Fiduciary

- Exercises any discretionary authority or control over the management of the plan, or
- Exercises any authority or control over the management and disposition of the plan assets, or
- Renders investment advice for a fee or other compensation, direct or indirect, with respect to any assets of the plan, or has any authority to render such advice, or
- Has any discretionary authority in the administration of the plan.

Fiduciary Liability: New DOL Regulations

- Department of Labor (DOL) fiduciary rule officially took effect on June 9, 2017
- Requires advisors providing investment advice to put clients’ interests first
- Expands the “investment advice fiduciary” definition, creating co-fiduciaries in many retirement plans

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Fiduciary Liability: Fiduciary Duties

- "Exclusive benefit" rule – to act solely in the interest of participants for the exclusive purpose of providing benefits and defraying reasonable expenses
- "Prudent Expert" rule – to act with the care, skill, prudence, and diligence of a prudent expert
- "Investment diversification" rule – to diversify the plan's investments to minimize the risk of large losses by offering a broad range of investment options which allow participants to balance risk and reward characteristics

Fiduciary Liability: Types of Named Fiduciaries

- Plan Administrator under ERISA Section 3(16) – generally the Employer unless another party is specifically named
- Investment Advisor under ERISA Section 3(21)
  - shares responsibility and has joint liability with Employer or Plan Administrator as a co-fiduciary
  - Employer has duty to select and monitor a 3(21) co-fiduciary and to determine if it is reasonable to rely on the 3(21) fiduciary's advice

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Fiduciary Liability: Types of Named Fiduciaries (cont'd)

- Investment Manager under ERISA Section 3(38)
  - Has discretion over plan's investments and has the power to manage, acquire, or dispose of any plan asset
  - Must acknowledge fiduciary status in writing
  - Employer and Plan Administrator are not responsible for decisions/actions of a 3(38) fiduciary, but must act prudently in selecting, monitoring, and retaining the 3(38) fiduciary
  - Must be a registered investment advisor, bank, or insurance company

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Fiduciary Liability: Ways to Minimize

- Buy liability insurance (separate from required ERISA fidelity bond)
- Hire professional experts as service providers
- Understand and evaluate all costs charged to participants; determine reasonableness
- Consider hiring co-fiduciaries for investment and admin functions
- Determine if any service providers are acting as co-fiduciaries; look at contracts and actions
- Monitor all service providers and all co-fiduciaries
- Follow the terms of the Plan document

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Fiduciary Liability: Ways to Minimize (cont'd)

- Comply with ERISA Section 404(c) re: investment options
- Select an appropriate QDIA for non-electing participants
- Establish and follow an Investment Policy Statement
- Provide employees with all required disclosures
- Educate your employees and offer guidance (not advice)
- Ensure your employees are not acting as fiduciaries inadvertently
- Document all fiduciary decisions and actions

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