Pension Plan Specialists, PC

RETIREMENT PLAN

News and Information for Employers

PLAN DESIGN CONSIDERATIONS

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Boosting Profits and Savings: 5 Tax Strategies for Business Owners

New Comparability Plans

Is It Time to Consider a Cash Balance Plan?

BOOSTING PROFITS AND SAVINGS: 5 TAX STRATEGIES FOR BUSINESS OWNERS

For business owners, striking a balance between operating costs and profit is the cornerstone of success.

Operating costs include everyday expenses like salaries, rent and supplies. Profit, on the other hand, is what remains after all these operating costs have been paid. It's the reward for the risks taken and the value created by your business. Often, savvy business owners will look to tax strategies to help find the sweet spot, where operating costs are managed efficiently while maximizing profit.

By utilizing tax-friendly strategies, owners can reduce their tax liability, effectively boosting profits without increasing sales or cutting costs. Let's delve into some of these strategies and explore how they could potentially bolster your business's financial health, reduce taxes and help you save for retirement.

5 TAX STRATEGIES TO CONSIDER

1. MAX OUT RETIREMENT PLAN CONTRIBUTIONS

Maximizing contributions to your retirement account reduces taxable income. If you are not maxing out your retirement plan each year, you're missing out on a significant tax advantage. The IRS adjusts the contribution limit annually with an extra boost of catch-up contributions.[1]

	401(K)	CATCH-UP	SUPER CATCH-UP
2025	$23,500	$7,500	$11,250

1 Internal Revenue Service. "Retirement Topics - 401(k) and Profit-Sharing Plan Contribution Limits."

2. PROFIT SHARING CONTRIBUTIONS

A profit sharing plan allows employers to make contributions to retirement savings accounts based on the company's profits. This incentivizes employees and provides tax benefits for the business.

Example

Murphy's Motors is a small business with two owners, both aged 57, and a diverse team of 20 employees. Murphy's Motors had a profitable year and wants to fund $110,000 into the profit sharing plan. After talking with their Third Party Administrator (TPA), the owners learn they can allocate $43,500 into one of the owner's accounts, $43,500 into the other owner's and $23,000 into eligible employees' accounts.

3. CASH BALANCE PLAN

These are types of defined benefit retirement plans. They offer an advantage to business owners by allowing them to contribute substantially larger annual amounts in comparison to other retirement plans, such as 401(k)s.

Example

The owners of Murphy's Motors are eager to accelerate their retirement savings. They each anticipate compensation of $250,000 for the current year. After maximizing their 401(k), catch-up and profit sharing contributions, they aim to each contribute and deduct an additional $100,000 toward their retirement savings. Upon consulting with their TPA, they discover that to achieve their combined savings goal of $200,000, they will need to contribute $50,000 toward their employees' retirement plans. This results in a substantial $250,000 tax deduction for their business.

4. HEALTH SAVINGS ACCOUNT (HSA)

An HSA is a tax-advantaged medical savings account for individuals enrolled in a high-deductible health plan (HDHP). Contributions to an HSA reduce taxable income. The funds grow tax-free and withdrawals for qualified medical expenses are tax-free. HSA contribution limits vary, they are dependent on coverage and age.[2]

5. HIRING FAMILY MEMBERS

While this may sound odd, hiring family members can be an effective tax strategy for business owners. By employing family members, you can transfer income from a higher to a lower tax bracket, potentially reducing your overall tax liability. The wages paid for legitimate work are deductible business expenses.

Example

Consider Joan Murphy, co-owner of Murphy's Motors. She employs her teenage son, Alex, for daily operations at the shop. Alex's wages are now a deductible business expense. If his earnings stay under the standard deduction of $15,000, they remain tax-free. Consult your tax professional for detailed advice.

> Every business is unique, with its own specific challenges, opportunities and goals. That's why we're here to help you explore these potential strategies, understand their implications and implement the ones that are right for you.

2 Internal Revenue Service. "Health Savings Accounts and Other Tax-Favored Health Plans."

NEW COMPARABILITY PLANS

One of the most common goals for a retirement plan is to provide a savings vehicle for the company's owner(s) and their employees. However, one problem—the IRS caps the amount of annual contributions participants can make. For employers, highly compensated employees and near-retirees looking to ramp up retirement savings, plan limits can create roadblocks. But, there are other options.

ENTER THE NEW COMPARABILITY PLAN

They are profit-sharing plans designed so owners, highly-compensated employees and older workers can receive higher contribution amounts while minimizing allocations to the accounts of younger, lower-paid employees.

Here's how they work. (see Table 1).

- Employees are divided into two or more groups based on age, length of service and/or compensation
- Each group in the plan receives a different level of contributions
- The separate groups are spelled out in the plan document while the contribution percentage can be determined each year
- Contributions are based on the benefit of those contributions at retirement

SAMPLE COMPARISON*

				Non-elective Safe Harbor		Traditional Profit Sharing		Age-Weighted Profit Sharing		New Comparability	
	Salary	Title	Age	% of Pay	Contribution Allocated	% of Pay	Contribution Allocated	% of Pay	Contribution Allocated	% of Pay	Contribution Allocated
Alex	$150,000	Owner	50	3%	$4,500	10%	$15,000	18%	$27,000	**25.6%**	**$38,500**
Charlie	$150,000	Owner	50	3%	$4,500	10%	$15,000	18%	$27,000	**25.6%**	**$38,500**
Sadie	$70,000	Director	50	3%	$2,100	10%	$7,000	18%	$12,600	**10%**	**$7,000**
Murphy	$40,000	Manager	30	3%	$1,200	10%	$4,000	8%	$5,000	**5%**	**$2,000**
Lola	$30,000	Manager	22	3%	$900	10%	$3,000	6%	$1,800	**5%**	**$1,500**
Employer Total					**$13,200**		**$44,000**		**$71,300**		**$87,500**

*Illustrative purposes only. Consult your TPA for specifics.

New Comparability Plans solve the issue of age-weighted plans where a 50-year-old owner can receive the same allocation as a 50-year-old worker. However, by dividing the company into different groups of workers, this plan type allows the 50-year-old owner to get a greater allocation than the 50-year-old worker.

WHAT TYPES OF COMPANIES CAN BENEFIT FROM A NEW COMPARABILITY PLAN?

Commonly used by small companies (generally fewer than 50 employees), plan decision makers could add New Comparability Plan design to an existing 401(k) plan and dramatically increase employer contributions to their owner(s). The plans work in many environments, but especially when there is a wide disparity in compensation and age between the owner and their key employees and the rest of the workforce.

New Comparability Plans can benefit a company if the owner:

- Wants to maximize employer contributions to themself and their executive team
- Is generally older than the rest of their employees
- Has a higher salary than most of their employees
- Wants to reward older employees

Table 1 illustrates how a New Comparability Plan gives this company's owners Alex and Charlie 25.6% of their salary which equates to $38,500 or 88% of the total employer contribution of $87,500.

DRAWBACKS

Critics say that New Comparability Plans are unfair since they benefit older, higher-compensated employees at the expense of younger, lower-paid employees. So the plans must pass strict non-discrimination testing—a special IRS general test.

The plan must pass non-discrimination tests each year to show they don't discriminate in favor of the highly compensated employees, which, of course, includes the owner.

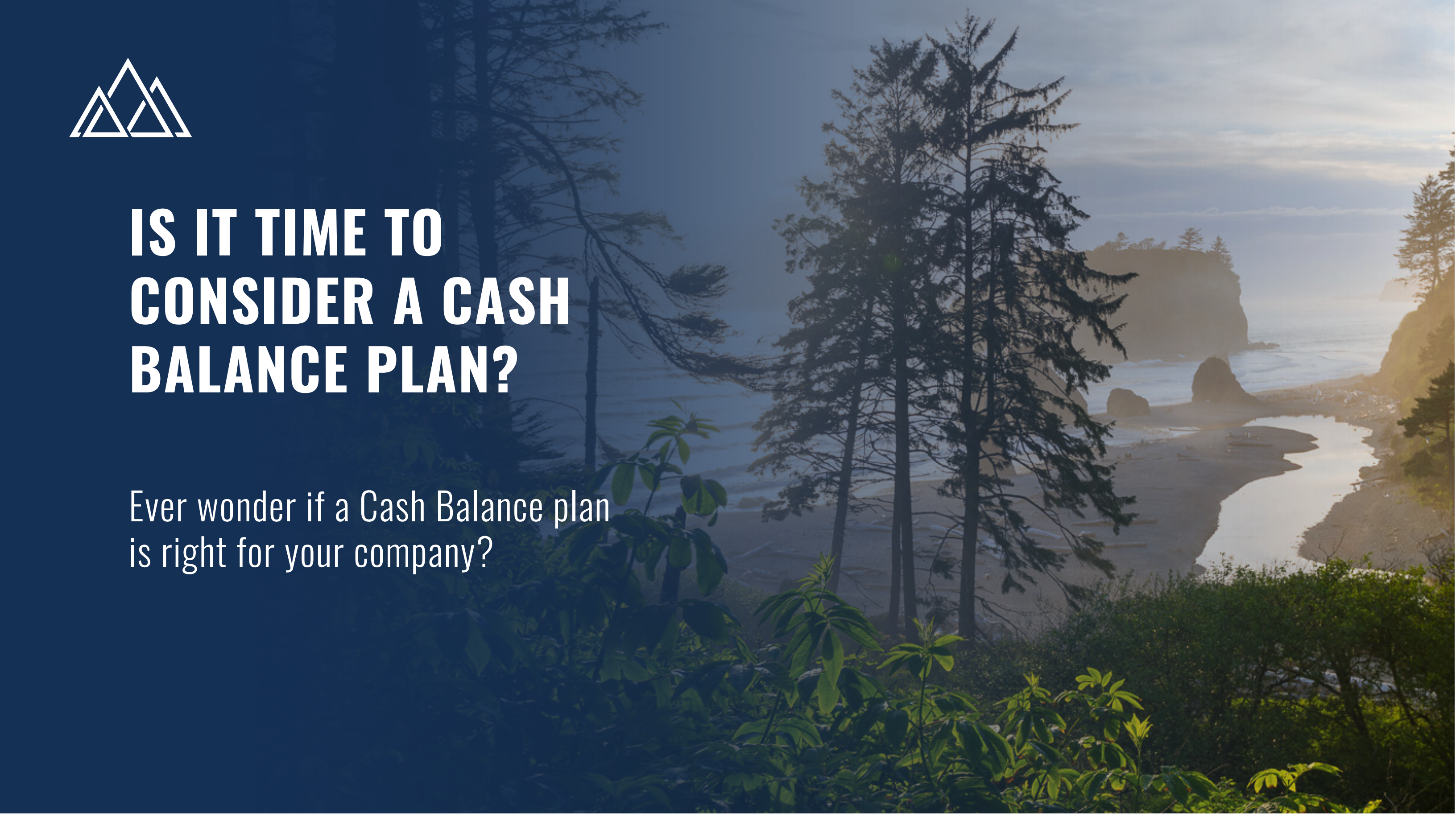
New Comparability Plans satisfy the test by requiring minimum contributions and then having the plan pass a series of tests to show that the projected benefits for each employee group meet the coverage requirements. The test can be complicated and difficult to pass, so it's important to design the plan properly so it can pass.

ARE THEY FOR YOU?

A New Comparability Plan can help you as the owner of a small business to direct the bulk of your company's contributions back to you, with certain restrictions imposed by the non-discrimination test.

It can be an attractive option depending on your company's demographics and compensation structure. Contact Pension Plan Specialists to discuss your plan. A New Comparability Plan can provide you a lot of flexibility in designing your retirement and compensation package.

They're not for everybody but are certainly worth looking into.



IS IT TIME TO CONSIDER A CASH BALANCE PLAN?

Ever wonder if a Cash Balance plan is right for your company?

> You may have heard about a "cash balance plan" and wondered whether it would be something advantageous for your business. A cash balance plan operates differently from other types of traditional retirement plans in that it combines features of both defined benefit and defined contribution plans.

Technically, a cash balance plan is classified as a defined benefit plan, which means it is subject to minimum funding requirements. Likewise, the investment of cash balance plan assets is managed by the employer or an investment manager appointed by the employer. Since cash balance plans are a "benefit," increases and decreases in the value of the actual plan's investments do not directly affect the amount promised to employees.

For example, if Jane is promised through a cash balance plan a $10,000 account value, then she is entitled to a $10,000 payment, whereas the actual value of Jane's account could be $8,000. The employer is responsible for making Jane's account whole. Or, vice versa, her account could be worth $12,000, yet she is only eligible to claim the $10,000 that is her accrued benefit.[3]

Typically, however, an employee benefit is expressed as a hypothetical account balance, giving it a defined contribution "feel." A participant's account is credited each year with a "pay credit," usually a percentage of pay, and also with an "interest credit," either a fixed or variable rate that is tied to an index. When a participant is eligible to receive benefits under a cash balance plan, the plan is treated as if it were a defined contribution plan with distributions available at termination of employment in the form of an annuity or a lump sum that can be rolled over into an IRA.

3 This example is a hypothetical illustration. It is not representative of any specific situation and your results will vary.

WHO ARE CASH BALANCE PLANS BEST SUITED FOR?

Cash balance plans are especially suited for self-employed or small business owners with high incomes, since these plans allow high-earning business owners to save more than the annual limit allowed set by the IRS for profit sharing/401(k) plans. Cash balance plans have generous contribution limits—upwards of $200,000 in annual wage deferral.

These plans allow for large annual tax deductions because the limitation is on the annual distribution that the plan participant may receive at retirement, not on the annual contribution to the plan as is the case with profit sharing or 401(k) plans. Employer contributions to a cash balance plan could potentially be three to four times their profit sharing/401(k) contributions and will vary depending on age, income, employee payroll and how much is currently invested in the plan.

Most cash balance plans are designed for the primary benefit of owners or executives of a company. Some candidates include professional practices (doctors, lawyers, accountants, architects, agencies, family-owned businesses, to name a few examples) who would like to minimize taxes by putting away their hard-earned dollars into tax-deferred accounts.

Additionally, cash balance plans can be appropriate when the owner or executive-level employees are several years older than most of the non-highly compensated employees. For more specifics, it's best to speak with a retirement plan advisor and Pension Plan Specialists for a sample plan design proposal.

THIS SOUNDS TOO GOOD TO BE TRUE, SO WHAT'S THE CATCH?

Downsides to sponsoring a cash balance plan include the need to commit to annual minimum funding levels over a period of 3-5 years, annual administration fees, investment management fees, and actuarial fees associated with the annual certification requirement showing that the plan is properly funded. Typically, the tax savings are advantageous and outweigh many of the disadvantages.

SHOULD I BE CONCERNED ABOUT CASH FLOW FLUCTUATIONS?

Businesses that may not want to make the commitment to a cash balance plan or that are not good candidates for it, but would nonetheless like to optimize retirement benefits for executive and other highly compensated employees, may want to consider a profit-sharing plan with an allocation method known as "new comparability" or "cross-testing."

With the new comparability plan, profit sharing contributions are allocated using the time value of money as a basis to allocate larger contributions to participants closer to retirement age. Depending on the demographic make-up of a company's work force, the new comparability allocation method can be an effective means of targeting contributions to certain senior highly compensated employees without committing to funding a defined benefit plan.

WHAT SHOULD I DO NEXT?

Plan design is largely dependent on the demographics of a business as well as the level of contributions with which the business is most comfortable. For these reasons, consulting with Pension Plan Specialists is highly recommended. We will create customized illustrations using your company's particular demographics to provide alternative plan designs for review and consideration.

Proper retirement plan design can help you fulfill your company's retirement plan objectives, such as maximizing benefits to key employees, tax deferral and efficient ways to minimize cost to the company.

The expertise you need. The attention you deserve. The creativity you want.

We deliver creative, accurate, and impactful retirement plan solutions to businesses that want to provide their employees with a secure and rewarding retirement. We are committed to building trust and focus on creating experiences, not transactions.

PENSION PLAN SPECIALISTS, PC

805 Broadway, Suite 600

Vancouver, WA 98660

360-694-8409

pensionplanspecialists.com

info@TPAteam.com

This information was developed as a general guide to educate plan sponsors and is not intended as authoritative guidance or tax/legal advice. Each plan has unique requirements and you should consult your attorney or tax advisor for guidance on your specific situation.