PENSION TRENDS

BY INDEPENDENT ACTUARIES, INC.

IndependentActuaries.com

Volume XXI, Issue I

February 2020

Push it to the Limit

Optimizing your Qualified Retirement Plans in 2020

Setting up a qualified retirement plan is an effective strategy that allows business owners to get a substantial tax deduction by saving for retirement. If a business owner wants to fully optimize the tax benefits of these plans, what's the most they can contribute and deduct each year?

The answer depends on several factors, but let's look at a few examples using the IRS limits for 2020:

Defined Contribution (DC) Plan

A business owner who sets up a defined contribution (DC) plan (such as a 401(k) profit sharing plan) can contribute up to $57,000 in 2020. Of the $57,000, up to $19,500 can come from salary deferrals (contributions made from the owner's compensation), and $37,500 would be classified as a profit sharing contribution, which is a contribution from the owner's business. If the owner is at least age 50, they can contribute an additional $6,500 "catch-up" contribution, for a total of $63,500 in 2020.

Defined Benefit (DB) Plan

If a business owner wants to contribute and deduct more than $63,500 per year, a defined benefit (DB) plan may be more appropriate. In a DB plan, the most an owner can contribute will depend on several factors including age, compensation, and the number of years they operate the plan. If an owner, age 52, sets up and maintains a plan for ten years, and then terminates the plan at age 62, the most they can roll over to an individual retirement account (IRA) is roughly $2.95 million as of 2020. Over ten years, this amounts to an average annual contribution of around $234,000, assuming 5% annual investment returns.

How about both?

The same business owner can set up and operate both a defined benefit plan and a defined contribution plan in order to contribute even more. Answering the question, "how much more?" will depend on the business. For some businesses, such as a business without employees, there is a combined plan deduction limit to consider. Continuing with our example above, we'll assume the business owner doesn't have employees, and is subject to this limit. As long as the owner contributes no more than 6% of their eligible compensation (or $17,100, if less) as a profit sharing contribution to the DC plan, they can still contribute the full amount to the DB plan. They can also make the maximum allowable salary deferrals. In our example, the most the owner can contribute to both plans in 2020 is as follows:

$234,000	DB plan contribution
$19,500	401(k) salary deferral
$6,500	401(k) catch-up
$17,100	Profit sharing contribution
$277,100	**Total deductible amount**

The numbers listed above will vary based on the circumstances of your business, and a plan design study is the best way to see how these numbers would shake out for you. If you are interested in exploring a qualified retirement plan with a free plan design study, contact an IAI Consultant through our website at IndependentActuaries.com, or call us at 503-520-0848.

To subscribe to our Pension Trends newsletter, visit IndependentActuaries.com and submit your email address. Or you can send an email to KristenMeredith@indact.com

To read previous issues of Pension Trends, visit our Pension Trends Archive at:

IndependentActuaries.com/ resources/general-resources/ pension-trends-newsletter/ pension-trends-archive/

Author Profile:

This article was written by Josh Harris, ASA, EA, MAAA. Josh's specialties and areas of interest include Defined Benefit plans, Other Post-Employment Benefits and Accounting Standards for retirement plans under GASB and ASC 715.

INDEPENDENT ACTUARIES, INC.

4500 Kruse Way, Suite 200
Lake Oswego, OR 97035
Phone: 503.520.0848
Fax: 503.520.1147
IndependentActuaries.com

email:
info@indact.com