

UNDERSTANDING CROSS-TESTING CALCULATIONS

Cross-testing is a calculation method used by retirement plan sponsors for allocating discretionary profit sharing contributions. They are often combined with 401(k) and safe harbor contributions to maximize annual contribution limits for owners at the lowest overall cost.

Cross-tested profit-sharing plans are similar to an age-weighted plan in that both types of plans allow a business to maximize discretionary profit sharing plan contributions to the older, higher-paid owners and key employees while minimizing allocations to younger employees. Cross-tested plans, however, take this one step further by putting employees into different classes or groups (rather than strictly using age) and assigning each class a different allocation percentage or dollar amount.

This example shows how a safe harbor 401(k) plan can use a cross-tested allocation to maximize specific owners. It is also possible to have each employee be in their own class so that benefits can vary by person. Although the benefits may differ, these plans are designed to pass IRS non-discrimination testing.

Safe Harbor 401(k) + Discretionary Profit Sharing					Discretionary Cross-Tested Profit Sharing						
	Wages	Age	EE Deferrals	% of Pay	3% Safe Harbor	% of Pay		% of Pay	Total ER Allocation	% of Pay	Total Contributions
Owner	275,000.00	55	24,500.00	8.8%	8,250.00	3.0%	28,250.00	10.27%	61,000.00	22.18%	61,000.00
Owner Spouse	20,000.00	47	18,500.00	90.0%	600.00	3.0%	400.00	2.00%	19,500.00	95.00%	19,500.00
Owner	60,000.00	48	6,000.00	10.0%	1,800.00	3.0%	3,600.00	6.00%	11,400.00	19.00%	11,400.00
	355,000.00		49,000.00		10,650.00		32,250.00		91,900.00		91,900.00
Office Manager	50,000.00	44	6,000.00	12.0%	1,500.00	3.0%	2,000.00	4.00%	3,500.00	7.00%	9,500.00
Employee 2	19,000.00	24	500.00	2.6%	570.00	3.0%	380.00	2.00%	950.00	5.00%	1,450.00
Employee 3	37,000.00	36	-	0.0%	1,110.00	3.0%	740.00	2.00%	1,850.00	5.00%	1,850.00
	106,000.00		6,500.00		3,180.00		3,120.00		6,300.00		12,800.00
Plan Total	461,000.00		55,500.00		13,830.00		35,370.00		98,200.00		104,700.00
Owner %							91%		93%		

Examples are for illustration purposes only and are based on 2018 limits.

When to Consider Cross-Tested Plan Benefits

Cross-Tested plans are designed to benefit older, more highly compensated employees. Contributions are calculated based on compensation and length of time to retirement. A cross-tested plan is generally used when business owners want to maximize their benefit and have a shorter time span until retirement than most of their employees. Employer contributions are also discretionary, which means the business is not obligated to make a contribution in leaner years.

For example, under a pro-rata allocation method, an employer would need to give each employee the same percentage of contribution, such as 20% of eligible compensation. Under the cross-tested method, the owner may keep a 20% contribution but provide employees with a lower amount, such as 5%. This reduces the total dollar amount of the employer contribution but also directs a larger portion of the total to the owners. Everyone in the plan still receives a benefit and the plan is able to pass non-discrimination testing.

Unlike Safe Harbor contributions, which are 100% vested, a vesting schedule can be applied to cross-tested contributions. Employers may also require an employee to work at least 1,000 hours and/or be employed on the last day of the plan year in order to receive a contribution.

While cross-tested plans may seem discriminatory, employer contributions are converted to equivalent benefit accrual rates (EBARs), which are then tested for nondiscrimination in a manner similar to the testing of defined benefit plans. They are specifically tested for nondiscrimination by comparing the *projected benefit* at retirement, not the current contribution level.

About QPS

QPS is a “Third Party” administration firm founded in 1997. At Qualified Pension Services, Inc. (QPS) we work with CPAs and Financial Advisors to custom design and administer retirement plans for business owners, large or small.

We have the expertise to design and administer truly custom fit retirement plans. We offer a secure pension portal where advisors and clients can access specific plan information or transmit data at any time.

- Upcoming eligibility reports and enrollment instructions are also available.
- QPS assigns each client their own individual plan consultant who is only a phone call away and truly understands their plan.

We hope you have found the above information useful. If you would like to see how Cross-Testing contributions would work for your situation please visit our website at www.qpsinc.biz - click on the request for a Free Proposal and forward to us today.

Faith Irmen 417-522-7526 x102 faithi@qpsinc.biz